THE LAW

OF

RAILWAY BONDS AND MORTGAGES

IN THE

UNITED STATES OF AMERICA.

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WITH

ILLUSTRATIVE CASES FROM ENGLISH AND COLONIAL COURTS.

BY

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TO

A. L. S.

PREFACE.

The idea of arranging the reported cases relating to railway bonds and mortgages on the plan here followed grew out of a collection of the Federal cases on this subject begun by me in 1884 for use in private practice. At that time there was no exhaustive work on this topic. Such collection was gradually added to by including the State cases, and subsequently, illustrative cases from English and other non-American Courts (including one or two cases from Hawaii) were woven into the book. Cases involving questions arising out of trust mortgages for the benefit of holders of bonds of gas and water and other miscellaneous companies have also been inserted.

The demands of an active practice have left only outside hours, during the past ten years, in which to arrange and oversee the arrangement of the cases embraced herein.

It has always been my view that the chief value of the text-book to the practitioner lies in the fact that, when properly compiled, it will enable him to find any point in the law of his subject which has either been decided, discussed, or even referred to incidentally. Ordinary Digests are incapable of such detail owing to lack of space.

Even if time permitted any practitioner who undertakes a legal work to cull out all the principles, compare and

analyze all the decisions, and accompany such comparison and analysis with his individual views, it is questionable whether the labor, time, and expense of such an ideal work would be compensated for by the help he would give his professional brethren, although his work should be thoroughly and ably done.

What the lawyer mainly wants is a case, or cases, on the particular points involved in the matter before him, and these he must consider from the point of view of his particular needs. No writer can foresee all the uses to which a judicial opinion may be put. These considerations are, of course, merely general ones. There are useful text-books of all kinds, and a few very able ones which almost conform to the above ideal,—such as Benjamin on Sales and Parsons (James) on Partnership, the latter one of the most unique in existence. The intelligent and successful practice of the law requires book learning, insight into principles, original creative imaginative thought, if I may use such an expression, and, more than all, good judgment. It is doubtless the fashion for lawyers pre-eminent in one rather than the other of these possessions to disparage the other. A learned codifier may emphasize the definiteness and certainty of statute law; an old-fashioned case lawyer may pour forth his too often empty names and dates; a brilliant advocate (lacking time for studious reading) may dwell on the elasticity and adaptability of the common law.

No practising lawyer can do the work required to produce an entirely satisfactory treatise on the case law of the average subject. The plan of a division of labor adopted in large modern encyclopædias of law is admirable, and should be adopted even in treatises on a single subject; but this is impracticable if the present style of

identifying the author with his work is to be followed. But States spend much money in codifying their statute law, and I have often thought that money should be spent by States in having their case law thoroughly digested in the form of text-books, the labor of the preparation of which should be greatly divided, even on a single subject, and paid for by the State, such works, of course, not to be authoritative statements of what the law is. Digesting should not be left as it is to the fancy and uncertain action of members of the bar, who can ill afford the necessary time.

Legal opinions are largely mere predictions of what courts would more or less certainly decide.

In the application of the principles and rules of law to the business life of the world, it is safer for clients that advice given should rest, wherever possible, on known decisions of controlling courts, rather than on the clever guesses of able counsel.

The author has attempted to give out a work which will assist, he hopes, the bench and bar in promptly finding discussions of points in which they are interested. To this end the index has been made as full as is consistent with the proper size of the book. This is the feature in which most text-books fail, although it is not necessary to carry an index as far as was done in Allibone's well-known story of the index which read, "Mind, his great," and when the reader of the life of the learned justice turned to the page indicated, found that he once had said "He had a great mind to commit the witness."

No one can be familiar with the decisions in this volume, especially those of the Federal Courts, without being impressed with the acuteness and vigor, independence and impartiality, learning and ability, which they display.

It is hoped that this book will assist the bench in preserving harmony in their decisions, and thus enhancing and keeping permanent the value of railway bonds in this country and England, so far as such value depends on certainty as to the rights and remedies of bondholders. This is alike in the interest of wage-earners and capitalists.

I believe that a code of equity practice in the Federal Courts would be of benefit to clients and practitioners, and that much of the practice relating to foreclosures could be advantageously codified, so as to produce uniform practice in all Circuits.

E. L. S.

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THE LAW

OF

RAILWAY BONDS AND MORTGAGES.

CHAPTER I.

NATURE AND ISSUE OF BONDS.

§ 1. **Power of Railway Companies generally to issue Bonds.**— The general rule is that private corporations, in the absence of an express prohibition, may borrow money and issue negotiable instruments in the transaction of their legitimate business; and until the contrary is shown, the legal presumption is that their acts in this connection are done in the regular course of their authorized business.[1]

[1] Railroad Co. *v.* Howard (1869), 7 Wall. 392; Com. *v.* Smith (1865), 10 Allen, 448; Savannah & C. R. Co. *v.* Lancaster (1878), 62 Ala. 555; Branch & Sons

A company is not impliedly prohibited from giving other evidences of debt besides bonds and debentures, by reason of the fact that those forms of obligations are alone mentioned in the act authorizing a loan to be secured by a pledge of its property.[1]

The power to issue bonds is, however, frequently limited by constitutional or statutory provisions, and some of these are noted in the succeeding sections.[2]

Railway companies have such powers as are specifically granted by statute, or as are necessary for the purpose of carrying into effect such powers, and no others. These powers are implied from the duties imposed by their charters. In the latter case

v. Atl. & Gulf R. Co. (1879), 3 Woods, 481. See also American Nat. Bank *v.* American Wood Paper Co. (R. I., 1895), 32 Atl. 305, as to the general principle that a private corporation has the power to issue negotiable bonds. See also Da Ponte *v.* Northern Pac. R. Co. (1883), 21 Blatch. 534; Miller *v.* R. & W. R. Co. (1863), 36 Vt. 452; McAllister *v.* Plant, 54 Miss. 106; McGregor *v.* Cov. & Lex. R. Co., 1 Dis. (Ohio) 509.

"It is a well-acknowledged rule that the right to contract debts carries with it the power to give negotiable notes or bills in payment or security for such debts, unless the corporation is restrained by its charter or statute from doing so." Rockwell *v.* Elkhorn Bank (1861), 13 Wis. 653, per Dixon, C. J. See also Commrs. of Craven County *v.* Atlantic, etc. R. Co. (1877), 77 N. C. 289.

On the power to borrow, see the following cases: Richards *v.* Merrimack & Conn. R. Co. (1862), 44 N. H. 127; Bardstown & Louisville R. Co. *v.* Metcalfe (1862), 4 Metc. (Ky.) 199; Kelly *v.* Trustees, etc. (1877), 58 Ala. 489; s. c. 21 Am. Ry. Rep. 138; Miller *v.* New York & E. R. Co. (1859), 18 How. Pr. 374; Brown *v.* Maryland (1880), 62 Md. 439; Duncomb *v.* N. Y., H. & N. R. Co. (1881), 84 N. Y. 190; s. c. 4 A. & E. R. R. Cas. 293; Phila. & Reading R. R. Co.'s Appeal (1882), 4 A. & E. R. R. Cas. 118; Union Bank *v.* Jacobs (1845), 6 Humph. (Tenn.) 515.

See also on this subject generally, Pierce on Railroads, 503; 1 Rorer on Railroads, 229, 237, 241, 244; 2 Redfield's Law of Railways, 536; 1 Woods' Railway Law, 523; note to 7 A. & E. R. R. Cas. 117; 2 Am. L. Reg. 713, 728. See also Kneeland *v.* Braintree St. Ry. Co. (Mass.), 45 N. E. Rep. 86; South Western Ark. & I. T. Ry. Co. *v.* Hays (Ark.), 38 S. W. Rep. 665.

In connection with subjects of this treatise see "Principles and Practice of Finance," by Edward Carroll, Jr.

[1] Commercial Bank *v.* Great Western Ry. Co., 3 Moore P. C. 295.

[2] For a construction of a power given in an English statute, see Landowners' West of England & South Wales Drainage and Inclosure Company *v.* Ashford (1880), L. R. 16 Ch. Div. 411, 437.

A special power of borrowing money by the issue of debentures secured by mortgage is given companies in the English Companies Clauses Act, 8 & 9 Vict., c. 16. It was claimed in this case that outside of the act the company were authorized to raise certain moneys. Fry, J., approved as an exposition of the law remarks of Mr. Justice Crompton, in his judgment in the case of Chambers *v.* Manchester & Milford Railway Company (1864), 5 B. & S. 588, 607.

Referring to section 8 of the special act, Mr. Justice Crompton said: "It is said that this leaves untouched the power of borrowing on bond or by simple contract, so that though the company can only borrow that sum on mortgage, the legislature have left to the company a larger power of borrowing money on other security. But it is a strange construction that by an enactment giving them a limited express power of borrowing, they are to have a general implied power of borrowing. I agree with Mr. Lush that the more natural construction is, that this is an enabling section giving power to the company which it would not otherwise have possessed, and that the directors cannot borrow money in any other way, so as to bind the company."

they are but incidents to the principal matter. An incidental power is one that is directly and immediately appropriate to the execution of the specific power granted, and not one that has a slight or remote relation to it.[1] These powers, whether express or implied, as incident to their creation, to make contracts, whether by bond, bill of exchange, or negotiable note, which are entered into in the usual and necessary course of their legitimate business, are upheld by the courts.[2]

The power of a corporation to issue bonds being independent of statute, it results that, if it is vested with authority to borrow money for specific purposes, it has the right to issue any instrument in acknowledgment of the debt which may be thought proper. Without any express provision empowering it to issue bonds, it may do so for the purpose mentioned in the enabling act.[3]

[1] McMasters *v.* Reed's Exrs. (1854), 1 Grant's Cases (Pa.), 36. Power to borrow money on mortgage does not imply that the company cannot issue bonds alone. Phila. & Sunbury R. Co. *v.* Lewis (1859), 33 Pa. St. 33. Bonds not avoided because mortgage securing them is invalid. Compare Bardstown & Louisville R. Co. *v.* Metcalfe (1862), 4 Metc. (Ky.) 199; Miller *v.* Rutland & W. R. Co. (1863), 36 Vt. 452; Richards *v.* Merrimack & Conn. R. Co. (1862), 44 N. H. 127.

[2] Phila. & Read. R. Co. *v.* Hickman (1857), 28 Pa. St. 318; White Valley Canal Co. *v.* Vallette (1858), 21 How. 414; Miller *v.* New York & E. R. Co. (1859), 18 How. Pr. 374; Commrs. of Craven County *v.* Atlantic & R. Co. (1877), 77 N. C. 289; Stratton *v.* Allen (1863), 16 N. J. Eq. 229; Bardstown & Louisville R. Co. *v.* Metcalfe (1862), 4 Metc. (Ky.) 199; Richards *v.* Merrimack & Conn. R. Co. (1862), 44 N. H. 127; Kelly *v.* Trustees, etc. (1877), 58 Ala. 489; s. c. 21 Am. Rep. 138; Brown *v.* State of Maryland (1884), 62 Md. 439; Hamilton *v.* Newcastle & Danville R. Co. (1857), 9 Ind. 359; Willoughby *v.* Chicago J. R. & Union Stock Yards Co., 50 N. J. Eq. 656; s. c. 25 Atl. Rep. 277.

[3] Miller *v.* New York & E. R. Co. (1859), 18 How. Pr. 374; Kelly *v.* Trustees, etc. (1877), 58 Ala. 489; s. c. 21 Am. Rep. 138. As to Massachusetts, see § 4, below. An English railway company, needing money to pay certain debts, and having exhausted its power of borrowing money, by advice of counsel resorted to the plan of selling portions of their rolling-stock to a wagon company for the money they wished, and leasing the same from the wagon company upon a contract which in its terms bound the railway company to repay the amount advanced, with interest, in payments annually, covering a period of five years. In an action for a part of the money due on the lease, the Court of Appeals held that the transaction was a legitimate one, and the wagon company entitled to a judgment against the railway company and the guarantors of the contract, certain of the company's directors. In the argument before the court, the rights of debenture-holders, as against rolling-stock, were referred to. In his opinion, Jessel, M. R., had this to say: "First of all, I am not going to say that debenture-holders have not some sort of security over rolling-stock, though what its precise nature may be is another matter. It may be that they have this kind of security, that is, a security on the rolling-stock for the time being, because it is always changing; it is not like a mortgage, subject to the right of the railway company not only to use it in the ordinary course of business, but to replace it in the ordinary course of business; that is to say, they may sell, or part with, or use these wagons, engines, locomotives, and so on, and replace them by others, either of a better description or otherwise, so that they may part with them for any reasonable purpose in the ordinary course of business. If there is a new invention, and they find they can buy some better

§ 2. **Constitutional Provisions as to the Issue of Bonds.** — The constitutions of some of the States of the United States contain various provisions in reference to the issue of bonds by railway companies. The text of these is given in the subjoined note.[1]

locomotives, they may part with the old stock; or if they become useless, and they can hire a better class of locomotives, I should say that they might part with them in the ordinary course of business. But as at present advised, I do not think they could sell the whole of the rolling-stock to pay the debts which were subsequent in priority to the debentures." Yorkshire Railway Co. *v.* Maclure (1882), L. R. 21 Ch. Div. 309, 314, 315; Phil. & Read. R. Co.'s Appeal, 11 W. N. C. 325; s. c. 4 Am. & Eng. R. R. Cas. 118; Gloninger *v.* Pittsburgh & Connellsville R. Co., 139 Pa. St. 13; s. c. 21 Fed. Rep. 211. See also Anglo-Australian Co., 16 N. S. Wales, 38; North Central Wagon Co. *v.* Manchester, etc. Ry. Co., 35 Ch. Div. 191; White *v.* Carmarthen Ry. Co., 1 H. & M. 786; Mowatt *v.* Castle Steel & Iron Works Co., 34 Ch. Div. 58.

[1] All the constitutional provisions relating to any of the subjects treated in this book are collected here, although some of them relate to subjects treated in other chapters.

Alabama. — Const., Art. XIV., § 6. "No corporation shall issue stock or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. The stock and bonded indebtedness of corporations shall not be increased, except in pursuance of general laws, nor without the consent of the persons holding the larger amount in value of stock, first obtained at a meeting to be held after thirty days' notice is given in pursuance of law."

The Alabama Supreme Court said in Nelson *v.* Hubbard, Adams' Cotton Mills *v.* Dimmick (1892), 96 Ala. 238, 250; s. c. 11 So. Rep. 428; 12 Ry. & Corp. L. J. 182: "The constitutional provision [Art. XIV., § 6], standing by itself, does not require that the amount of money, or the value of the labor or property for which stock or bonds are issued, shall correspond with the face value of the stock or bonds for which it is issued. . . . In the case of bonds there is not, as there is in the case of stock subscribed, any statutory provision requiring the value or consideration received by the corporation to correspond with the amount, or nominal or face value, of the bonds issued therefor. Such bonds are not issued in contravention of the provision contained in the first sentence of the above-mentioned section of the constitution if the issue does not effect a 'fictitious increase of indebtedness,' and if they can properly be regarded as issued for 'money, labor done, or money or property actually received.' The constitutional provision in question operates to invalidate evidence of indebtedness when there is in fact no debt; to require every issue of stocks or bonds of private corporations to represent substantial values received by the corporations; to impose upon those charged with the disposition of corporate securities the duty to procure therefor a fair and reasonable equivalent in money, labor, or property actually contributed to the corporation. Courts of the highest authority which have considered the effects of such provisions have not construed them, when not fortified by more stringent statutory requirements, as invalidatory issues of stocks and bonds in exchange for money, property, or labor, upon such terms as the corporate authorities, in the fair exercise of their judgment and discretion, may deem proper, though the amount received therefor was less than the face value of the securities. The negotiation of bonds must be a real transaction, carried through to promote legitimate corporate purposes, and not a mere trick or device to evade the law and impose greater obligations upon the corporation than there is any occasion for it to assume in order to obtain the consideration received thereof. Issues of stocks and bonds have been sustained under constitutional or statutory provisions of the same import as the one under consideration, when they were disposed of for the best price that could be obtained, though for considerably less than their face value." Memphis & Little Rock Railroad *v.* Dow (1887), 120 U. S. 287; s. c. 7 Sup. Ct. Rep. 482; Peoria & Springfield

§ 3. Special Charter Provisions as to Issue of Bonds. — When companies are organized under special legislative charters, and

R. Co. *v.* Thompson (1882), 103 Ill. 187; Stein *v.* Howard (1884), 65 Cal. 616; Handley *v.* Stutz (1891), 139 U. S. 417; s. c. 11 Sup. Ct. Rep. 511; Clark *v.* Bever (1891), 139 U. S. 96; s. c. 11 Sup. Ct. Rep. 468; Fogg *v.* Blair (1891), 139 U. S. 118; s. c. 11 Sup. Ct. Rep. 476. The power "to borrow money, and to mortgage, or otherwise convey or pledge its property, real or personal, and its franchises, to secure the payment of the money so borrowed, or any other debt contracted by it," includes the power to pledge the bonds of the corporation, secured by its mortgage on property as collateral security for debts of the corporation presently created or already owing. . . . "And we do not think that such pledge, if made without fraud, and solely for the *bona fide* purpose of satisfactorily securing the payment of corporate debts, can properly be regarded as effecting a fictitious increase of indebtedness, or as not issued for money, labor done, or money or property actually received, though the amount of the bonds pledged exceeds the amount of the indebtedness to be secured."

See Coe *v.* East & West R. Co. of Alabama *et al.* (1892), 52 Fed. Rep. 531, and Grant *et al. v.* East & West R. Co. of Alabama *et al.* (1893), 54 Fed. Rep. 569, for a construction of this provision in the Constitution of Alabama.

Const., Art. XIV., § 9. "No corporation shall issue preferred stock without the consent of the owners of two-thirds of the stock of said corporation."

Const., Art. XIV., § 11. ". . . No telegraph company shall consolidate with, or hold a controlling interest in, the stock or bonds of any other telegraph company owning a competing line, or acquire, by purchase or otherwise, any other competing line of telegraph."

Arkansas. — Const., Art. XII., § 8. "No private corporation shall issue stocks or bonds, except for money or property actually received or labor done, and all fictitious increase of stock or indebtedness shall be void; nor shall the stock or bonded indebtedness of any private corporation be increased, except in pursuance of general laws; nor until the consent of the persons holding the larger amount in value of stock shall be obtained at a meeting held after notice given for a period not less than sixty days, in pursuance of law."

See Memphis & Little Rock Railroad *v.* Dow (1887), 120 U. S. 287, where this provision of the Constitution of Arkansas is construed by the U. S. Supreme Court.

Const., Art. XVII., § 11. "The rolling-stock and all other movable property belonging to any railroad company or corporation in this State shall be considered personal property, and shall be liable to execution and sale in the same manner as the personal property of individuals, and the general assembly shall pass no law exempting any such property from execution and sale."

California. — Const., Art. XII., § 10. "The legislature shall not pass any laws permitting the leasing or alienation of any franchise, so as to relieve the franchise or property held thereunder from the liabilities of the lessor or grantor, lessee or grantee, contracted or incurred in the operation, use, or enjoyment of such franchise, or any of its privileges."

Const., Art. XII., § 11. "No corporation shall issue stocks or bonds, except for money paid, labor done, or property actually received, and all fictitious increase of stock or indebtedness shall be void. The stock and bonded indebtedness of corporations shall not be increased except in pursuance of general law, nor without the consent of the persons holding the larger amount in value of the stock, at a meeting called for that purpose, giving sixty days' public notice, as may be provided by law."

As to first clause, see Farmers' Loan & Trust Co. *v.* San Diego St. Car Co. (1891), 45 Fed. Rep. 518; Ewing *v.* Oroville Mining Co. (1880), 56 Cal. 649; Underhill *v.* Santa Barbara Land, Building, & Improvements Co. (1892), 93 Cal. 300; s. c. 28 Pac. Rep. 1049.

It was held in Union L. & T. Co. *v.* Southern Cal. Motor Road Co. (1892), 51 Fed. Rep. 840, that the provision in the Constitution of California prohibiting that the bonded indebtedness of corporations

not under general laws, such charters frequently contain provisions expressly authorizing the issue of bonds.[1]

shall not be increased without the consent of the persons holding the larger amount of stock, does not apply to the first issue of bonds. That provision is strictly limited to the "increase" of such indebtedness, and has no application to its "creation."

Colorado. — Const., Art. XV., § 9. "No corporation shall issue stocks or bonds, except for labor done, service performed, or money or property actually received, and all fictitious increase of stock or indebtedness shall be void."

The meaning of this provision is, that an issue of bonds except as above stated is in direct violation of the constitution, and *ipso facto* invalid. Arkansas River, Land, Town, & Canal Co. *et al.* *v.* Farmers' Loan & Trust Co. *et al.* (1889), 13 Col. 587, 601; s. c. 22 Pac. Rep. 959.

Const., Art. XV., § 5. "No railroad corporation, or the lessees or managers thereof, shall consolidate its stock, property, or franchises with any other railroad corporation owning or having under its control a parallel or competing line."

Georgia. — Const., Art. IV., § 2, par. 4. Buying stock, etc., in other corporations; competition. "The General Assembly of this State shall have no power to authorize any corporation to buy shares or stock in any other corporation in this State or elsewhere, or to make any contract or agreement whatever with any such corporation which may have the effect, or be intended to have the effect, to defeat or lessen competition in their respective businesses, or to encourage monopoly; and all such contracts and agreements shall be illegal and void."

Idaho. — Const., Art. XI., § 9. "No corporation shall issue stocks or bonds except for labor done, services performed, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. . . ."

Const., Art. XI., § 14. "If any railroad, telegraph, express, or other corporation, organized under any of the laws of this State, shall consolidate, by sale or otherwise, with any railroad, telegraph, express, or other corporation organized under any of the laws of any other State or Territory, or of the United States, the same shall not thereby become a foreign corporation; but the courts of this State shall retain jurisdiction over that part of the corporate property within the limits of the State in all matters that may arise, as if said consolidation had not taken place."

Const., Art. XI., § 15. "The legislature shall not pass any law permitting the leasing or alienation of any franchise so as to release or relieve the franchise or property held thereunder from any of the liabilities of the lessor or grantor, or lessee or grantee, constructed or incurred in the operation, use, or enjoyment of such franchise, or any of its privileges."

Illinois. — Const., Art. XI., § 10. "The rolling-stock, and all other movable property belonging to any railroad company or corporation in this State, shall be considered personal property, and shall be liable to execution and sale in the same manner as the personal property of individuals, and the general assembly shall pass no law exempting any such property from execution and sale."

Const., Art. XI., § 11. "No railroad corporation shall consolidate its stock, property, or franchises with any other railroad corporation owning a parallel or competing line; and in no case shall any consolidation take place, except upon public notice given of at least sixty days, to all

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[1] Coe *v.* Columbus, P. & I. R. Co. (1859), 10 Ohio St. 372 (company empowered to borrow a sum not exceeding its capital stock, at a specified rate of interest, and to execute bonds therefor); Garrett *v.* May, 19 Md. 187 (1862) (company empowered to borrow money on its credit, and execute bonds, secured by pledge of property).

See also McAllister *v.* Plant (1876), 54 Miss. 106; s. c. 17 Am. Ry. Rep. 389; Kemble *v.* Wilmington & Northern R. Co. (1878), 13 Phila. 469; Da Ponte *v.* Northern Pac. R. Co. (1883), 21 Blatchf. 564.

The inherent power of a railroad company to borrow money and mortgage its property is not limited by a clause in its charter

stockholders, in such manner as may be provided by law. A majority of the directors of any railroad corporation, now incorporated or hereafter to be incorporated by the laws of this State, shall be citizens and residents of this State."

Rev. Stat. Ill. Const., Art. XI., § 13. "No railroad corporation shall issue any stock or bonds, except for money, labor, or property actually received, and applied to the purposes for which such corporation was created; and all stocks, dividends, and other fictitious increase of the capital stock or indebtedness of any such corporation shall be void. . . ."

In Peoria & S. R. Co. *v.* Thompson (1882), 103 Ill. 187; s. c. 7 A. & E. R. R. Cas. 101, this provision of the constitution has been held not to have been intended to interfere with the usual and customary methods of raising funds by railroad companies by the issue of its stocks and bonds for the purpose of building their roads, or of accomplishing other legitimate corporate purposes.

In City of Chicago *v.* Cameron (1887), 120 Ill. 447; s. c. 11 N. E. Rep. 899, bonds issued, not for the construction of the road, but to pay the debt of another corporation, were held to be void as against holders with notice of the purposes of their issue.

Kentucky. — Const., § 193. "No corporation shall issue stock or bonds except for an equivalent in money paid or labor done, or property actually received and applied to the purposes for which such corporation was created, and neither labor nor property shall be received in payment of stock or bonds at a greater value than the market price at the time said labor was done or property delivered, and all fictitious increase of stock or indebtedness shall be void."

Const., § 200. "If any railroad, telegraph, express, or other corporation, organized under the laws of this Commonwealth, shall consolidate, by sale or otherwise, with any railroad, telegraph, express, or other corporation organized under the laws of any other State, the same shall not thereby become a foreign corporation, but the courts of this Commonwealth shall retain jurisdiction over that part of the corporate property within the limits of this State in all matters which may arise as if said consolidation had not taken place."

Const., § 201. "No railroad, telegraph, telephone, bridge, or common carrier company shall consolidate its capital stock, franchises, or property, or pool its earnings, in whole or in part, with any other railroad, telegraph, telephone, bridge, or common carrier company owning a parallel or competing line or structure, or acquire by purchase, lease, or otherwise any parallel or competing line or structure, or operate the same. . . ."

In Louisville & Nashville R. Co. *v.* Kentucky (1896), 161 U. S. 677; s. c. 16 Sup. Ct. Rep. 714, the railroad company sought to consolidate with a parallel or competing railroad. The U. S. Supreme Court held that, conceding that the requisite power existed in both the companies as claimed, sect. 201 of the Constitution of Kentucky, adopted in 1891, was a legitimate exercise of the police power of the State, and forbade such consolidation, at least so far as such power remained unexecuted.

Const., § 203. "No corporation shall lease or alienate any franchise so as to relieve the franchise or property held thereunder from the liabilities of the lessor or grantor, lessee or grantee, contracted or incurred in the operation, use, or enjoyment of such franchise, or any of its privileges."

Const., § 212. "The rolling-stock and other movable property belonging to any railroad corporation or company in this State shall be considered personal property, and shall be liable to execution and sale in the same manner as the personal property of individuals. The earnings of any railroad company or corporation, and choses in action, money, and personal property of all kinds belonging to it in the hands, or under the control, of any officer, agent, or employee of such corporation or company, shall be subject to process of attachment to the same extent and

providing that shares shall not be assessed over one hundred dollars, and that if more money is necessary it shall be raised by creating new shares.[1]

in the same manner as like property of individuals when in the hands or under the control of other persons. Any such earnings, *choses in action*, money, or other personal property may be subjected to the payment of any judgment against such corporation or company, in the same manner and to the same extent as such property of individuals in the hands of third persons."

Louisiana. — Const., Art. 238. "No corporation shall issue stock nor bonds, except for labor done or money or property actually received, and all fictitious issues of stock shall be void, and any corporation issuing such fictitious stock shall forfeit its charter."

Const., Art. 246. "If any railroad company, organized under the laws of this State, shall consolidate, by sale or otherwise, with any railroad company organized under the laws of any other State or of the United States, the same shall not thereby become a foreign corporation, but the courts of this State shall retain jurisdiction in all matters which may arise, as if said consolidation had not taken place. In no case shall any consolidation take place except upon public notice of at least sixty days to all stockholders, in such manner as may be provided by law."

Mississippi. — Const., Art. VII., § 185. "The rolling-stock belonging to any railroad company or corporation in this State shall be considered personal property, and shall be liable to execution and sale as such."

Const., Art. VII., § 196. "No transportation corporation shall issue stocks or bonds except for money, labor done (or in good faith agreed to be done), or money or property actually received; and all fictitious increase of stock or indebtedness shall be void."

Michigan. — Const., Art. XIX. A, § 2. "No railroad corporation shall consolidate its stock, property, or franchises with any other railroad corporation owning a parallel or competing line; and in no case shall any consolidation take place except upon public notice given of at least sixty days to all stockholders, in such manner as shall be provided by law."

Missouri. — Const., Art. XII., § 8. "No corporation shall issue stock or bonds, except for money paid, labor done, or property actually received, and all fictitious increase of stock or indebtedness shall be void. The stock and bonded indebtedness of corporations shall not be increased, except in pursuance of general law, nor without the consent of the persons holding the larger amount in value of the stock first obtained at a meeting called for the purpose, first giving sixty days' public notice, as may be provided by law."

Const., Art. XII., § 10. "No corporation shall issue preferred stock without the consent of all the stockholders."

Const., Art. XII., § 16. "The rolling-stock and all other movable property belonging to any railroad company or corporation in this State shall be considered personal property, and shall be liable to execution and sale in the same manner as the personal property of individuals; and the general assembly shall pass no law exempting any such property from execution and sale." See Knapp *v.* St. Louis, Kansas City, & Northern Ry. Co. (1881), 74 Mo. 374.

Const., Art. XII., § 17. "No railroad or other corporation, or the lessees, purchasers, or managers of any railroad corporation, shall consolidate the stock, property, or franchises of such corporation with, or lease or purchase the works or franchises of, or in any way control, any railroad corporation owning or having under its control a parallel or competing line; nor shall any officer of such railroad corporation act as an officer of any other railroad corporation owning or having the control of a parallel or competing line. The question whether railroads are parallel

[1] Richards *v.* Merrimack & Conn. River R. Co. (1862), 44 N. H. 127.

Business corporations were authorized by section 13 of the act of 1875, as amended by chapter 394 of the Laws of New York, 1888, to

or competing lines shall, when demanded, be decided by a jury, as in other civil issues."

Const., Art. XII., § 18. "If any railroad company organized under the laws of this State shall consolidate, by sale or otherwise, with any railroad company organized under the laws of any other State or of the United States, the same shall not thereby become a foreign corporation; but the courts of this State shall retain jurisdiction in all matters which may arise, as if said consolidation had not taken place. In no case shall any consolidation take place, except upon public notice of at least sixty days to all stockholders, in such manner as may be provided by law."

Montana. — Const., Art. XV., § 6. "No railroad corporation, express or other transportation company, or the lessees or managers thereof, shall consolidate its stock, property, or franchises with any other railroad corporation, express or other transportation company, owning or having under its control a parallel or competing line; neither shall it in any manner unite its business or earnings with the business or earnings of any other railroad corporation; nor shall any officer of such railroad, express, or other transportation company act as an officer of any other railroad, express, or other transportation company owning or having control of a parallel or competing line."

Const., Art. XV., § 10. "No corporation shall issue stocks or bonds, except for labor done, services performed, or money and property actually received; and all fictitious increase of stock or indebtedness shall be void. . . ."

Const., Art. XV., § 15. "If any railroad, telegraph, telephone, express, or other corporation or company organized under any of the laws of this State shall consolidate, by sale or otherwise, with any railroad, telegraph, telephone, express, or other corporation organized under any of the laws of any other State or Territory, or of the United States, the same shall not thereby become a foreign corporation; but the courts of this State shall retain jurisdiction over that part of the corporate property within the limits of the State, in all matters that may arise, as if said consolidation had not taken place."

Const., Art. XV., § 17. "The legislative assembly shall not pass any law permitting the leasing or alienation of any franchise so as to release or relieve the franchise or property held thereunder from any of the liabilities of the lessor or grantor, or lessee or grantee, contracted or incurred in the operation, use, or enjoyment of such franchise, or any of its privileges."

Nebraska.— Const., Art. XI., § 2. "The rolling-stock and all other movable property belonging to any railroad company or corporation in this State shall be liable to execution and sale in the same manner as the personal property of individuals, and the legislature shall pass no law exempting any such property from execution and sale."

Const., Art. XI., § 3. "No railroad corporation or telegraph company shall consolidate its stock, property, franchises, or earnings, in whole or in part, with any other railroad corporation or telegraph company owning a parallel or competing line: and in no case shall any consolidation take place, except upon public notice of at least sixty days to all stockholders, in such manner as may be provided by law."

The sense in which the word "consolidate" is used is that of "join" or "unite." State *ex rel.*, etc. *v.* Atchison & Nebraska R. Co. (1888), 24 Neb. 143, 164; s. c. 38 N. W. Rep. 43.

Const., Art. XI., § 5. "No railroad corporation shall issue any stock or bonds, except for money, labor, or property actually received and applied to the purposes for which such corporation was created, and all stock, dividends, and other fictitious increase of the capital stock or indebtedness of any such corporation shall be void. . . ."

See State *ex rel.*, etc. *v.* Atchison & Nebraska R. Co. (1888), 24 Neb. 143, 164; s. c. 38 N. W. Rep. 43.

North Dakota. — Const., Art. VII.,

issue bonds and to mortgage their real estate to an amount not to exceed one-half of the entire corporate property. The section

§ 138. "No corporation shall issue stock or bonds except for money, labor done, or money or property actually received ; and all fictitious increase of stock or indebtedness shall be void.

"The stock and indebtedness of corporations shall not be increased except in pursuance of general law, nor without the consent of the persons holding the larger amount in value of the stock first obtained at a meeting to be held after sixty days' notice, given in pursuance of law."

§ 141. "No railroad corporation shall consolidate its stock, property, or franchises with any other railroad corporation owning a parallel or competing line ; and in no case shall any consolidation take place except upon public notice given at least sixty days to all stockholders, in such manner as may be provided by law. Any attempt to evade the provisions of this section by any railroad corporation, by lease or otherwise, shall work a forfeiture of its charter."

Pennsylvania. — Const., Art. XVI., § 7. "No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received ; and all fictitious increase of stock or indebtedness shall be void. The stock and indebtedness of corporations shall not be increased except in pursuance of general law, nor without the consent of the persons holding the larger amount in value of the stock, first obtained at a meeting to be held after sixty days' notice given in pursuance of law."

See Rothschild *v.* Rochester & Pittsburgh R. Co. (1887), 1 Ry. & Corp. L. J. 321, reversing Appeal of State Line R. Co. (1880), 1 Ry. & Corp. L. J. 139 ; Ahl *v.* Rhoades (1877), 84 Pa. St. 319; Glossinger *v.* Pittsburgh & Connellsville R. Co. (1890), 139 Pa. St. 13 ; s. c. 21 Atl. Rep. 211 ; 27 W. N. C. 497 ; Lewis *v.* Jeffries (1878), 86 Pa. St. 340 ; Powell *v.* Blair (1890), 133 Pa. St. 550 ; s. c. 19 Atl. Rep. 559. The provision of the Constitution of Pennsylvania as to fictitious increase of indebtedness has been held not to apply to the sale of mortgage bonds of a railroad company for which it received the money from innocent purchasers at par for construction and equipment. The debt would not be fictitious, though the securities might turn out to be largely so. Fidelity, etc. Co. *v.* West Penn., etc. R. Co. *et al.* (1891), 138 Pa. St. 494 ; s. c. 21 Atl. Rep. 21. As to notice of a meeting to increase stock under this constitutional provision see Shopp *v.* Norristown Pass. Ry. Co., 2 Pa. Dist. Rep. 679. See as to issuing deferred income bonds, McCalmont *v.* Phil. & Read. R. Co., 14 Phil. 479.

Where plans have been perfected for a consolidation of railroad companies and the building of another, a mortgage executed and bonds executed and sold, and the purchase-money of the bonds applied to the purposes for which the mortgage and negotiations stated they were to be used, such bonds are not issued in contravention of the constitutional provision of Pennsylvania, that "No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received ; and all fictitious increase of stock or indebtedness shall be void." Woodbury *et al.* *v.* Allegheny & K. R. Co. *et al.* (1895), 72 Fed. Rep. 371.

Const., Art. XVII., § 4. "No railroad, canal, or other corporation, or the lessees, purchasers, or managers of any railroad or canal corporation, shall consolidate the stock, property, or franchises of such corporation with, or lease or purchase the works or franchises of, or in any way control any other railroad or canal corporation owning or having under its control a parallel or competing line ; nor shall any officer of such railroad or canal corporation act as an officer of any other railroad or canal corporation owning or having the control of a parallel or competing line ; and the question whether railroads or canals are parallel or competing lines shall, when demanded by the party complainant, be decided by a jury as in other civil issues."

South Carolina. — Const., Art. IX., § 7. "No railroad or other transportation company, and no telegraph or other transmitting corporation, or the lessees, purchasers, or managers of such corporation,

did not imply that bonds in excess of that amount would be void, but only that the directors should be personally liable for any

shall consolidate the stock, property, or franchises of such corporation with, or lease or purchase the works or franchises of, or in any way control any other railroad or other transportation, telegraph, or other transmitting company owning or having under its control a parallel or competing line; and the question whether railroads or other transportation, telegraph, or other transmitting companies are parallel or competing lines shall, when demanded by the party complainant, be decided by a jury as in other civil causes."

South Dakota. — Const., Art. XVII., § 8. "No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. . . . The stock and indebtedness of corporations shall not be increased except in pursuance of general law, nor without the consent of the persons holding the larger amount in value of the stock first obtained, at a meeting to be held after sixty days' notice given in pursuance of law."

Const., Art. XVII., § 13. "The rolling-stock and all other movable property belonging to any railroad company or corporation in this State shall be considered personal property, and shall be liable to execution and sale in the same manner as the personal property of individuals, and the legislature shall pass no laws exempting such property from execution and sale."

Const., Art. XVII., § 14. "No railroad corporation shall consolidate its stock, property, or franchises with any other railroad corporation owning a parallel or competing line; and in no case shall any consolidation take place except upon public notice given out, at least sixty days, to all stockholders in such manner as may be provided by law. Any attempt to evade the provisions of this section by any railroad corporation, by lease or otherwise, shall work a forfeiture of its charter."

Texas. — Const., Art. III., § 54. "The legislature shall have no power to release or alienate any lien held by the State upon any railroad, or in any wise change the tenor or meaning or pass any act explanatory thereof; but the same shall be enforced in accordance with the original terms upon which it was acquired."

Const., Art. X., § 4. "The rolling-stock and all other movable property belonging to any railroad company or corporation in this State shall be considered personal property, and its real and personal property, or any part thereof, shall be liable to execution and sale in the same manner as the property of individuals; and the legislature shall pass no laws exempting any such property from execution and sale.

Const., Art. X., § 5. "No railroad or other corporation, or the lessees, purchasers, or managers of any railroad corporation, shall consolidate the stock, property, or franchises of such corporation with, or lease or purchase the works or franchises of, or in any way control any railroad corporation owning or having under its control a parallel or competing line; nor shall any officer of such railroad corporation act as an officer of any other railroad corporation owning or having the control of a parallel or competing line."

Const., Art. X., § 6. "No railroad company organized under the laws of this State shall consolidate, by private or judicial sale or otherwise, with any railroad company organized under the laws of any other State or of the United States."

Const., Art. XII., § 6. "No corporation shall issue stock or bonds except for money paid, labor done, or property actually received, and all fictitious increase of stock or indebtedness shall be void."

In Northside Ry. Co. *v.* Worthington, 88 Texas, 573 (1895), the court says: "The decisions of the courts upon like provisions in the Constitutions of other States have been such as in most cases to practically destroy its effect. It may be that it was not intended to prohibit corporations from selling their bonds below par, — provided the transaction was in good faith."

Utah. — Const., Art. XII., § 5. "Corporations shall not issue stock, except to *bona fide* subscribers thereof or their

damages to bondholders or mortgage-holders caused by such excess.[1]

An objection may be taken to the validity of a mortgage secur-

assignee, nor shall any corporation issue any bond or other obligation for the payment of money, except for money or property received or labor done. . . . All fictitious increase of stock or indebtedness shall be void."

Const., Art. XII., § 7. "No corporation shall lease or alienate any franchise, so as to relieve the franchise or property held thereunder from the liabilities of the lessor or grantor, lessee or grantee, contracted or incurred in operation, use, or enjoyment of such franchise or of its privileges."

Const., Art. XII., § 13. "No railroad corporation shall consolidate its stock, property or franchise with any other railroad corporation owning a competing line."

Const., Art. XII., § 14. "The rolling-stock and other movable property belonging to any railroad company or corporation in this State shall be considered personal property, and shall be liable to taxation and to execution and sale in the same manner as the personal property of individuals, and such property shall not be exempted from execution and sale."

Washington. — Const., Art. XII., § 6. "Corporations shall not issue stock, except to *bona fide* subscribers therefor or their assignees; nor shall any corporation issue any bond, or other obligation for the payment of money, except for money or property received or labor done. . . . All fictitious increase of stock or indebtedness shall be void."

Const., Art. XII., § 8. "No corporation shall lease or alienate any franchise, so as to relieve the franchise or property held thereunder from the liabilities of the lessor or grantor, lessee or grantee, contracted or incurred in the operation, use, or enjoyment of such franchise or any of its privileges."

Const., Art. XII., § 16. "No railroad corporation shall consolidate its stock, property, or franchises with any other railroad corporation owning a competing line."

Const., Art. XII., § 17. "The rolling-stock and other movable property belonging to any railroad company or corporation in this State shall be considered personal property, and shall be liable to taxation and to execution and sale in the same manner as the personal property of individuals, and such property shall not be exempted from execution and sale."

West Virginia. — Const., Art. XI., § 8. "The rolling-stock and all other movable property belonging to any railroad company or corporation in this State shall be considered personal property, and shall be liable to execution and sale in the same manner as the personal property of individuals; and the legislature shall pass no law exempting any such property from execution and sale."

Const., Art. XI., § 11. "No railroad corporation shall consolidate its stock, property, or franchise with any other railroad owning a parallel or competing line, or obtain the possession or control of such parallel or competing line, by lease or other contract, without the permission of the legislature."

Wyoming. — Const., Art. X., § 8. "There shall be no consolidation or combination of corporations of any kinds whatever to prevent competition, to control or influence productions or prices thereof, or in any manner to interfere with the public good and general welfare."

As to the effect of charter provisions and statutes on issuing bonds, see Geddes *v.* Toronto St. R. Co., 14 Up. Can. C. P. Rep. 513; Winnipeg & H. B. R. Co. *v.* Mann, 7 Man. 81; East Boston Freight R. Co. *v.* Hubbard, 10 Allen, 459, *note;* Miller *v.* New York & Erie R. Co., 8 Abb. Pr. 431; s. c. 18 How. Pr. 374. As to the effect of reorganization agreement, see Dutenhofer *v.* Adirondacks R. Co., 60 Hun, 578, under a statute authorizing an issue of bonds to creditors as payees. McCullough *v.* A. & E. R. Co., 4 Gill (Md.), 58.

[1] Beebe *v.* Richmond Light, Heat, & Power Co., 13 Misc. Rep. 737; s. c. 35 N. Y. Suppl. 1 (1895).

ing bonds, on the ground that there is a want of power under its charter to construct its road on the line selected, and consequently to borrow money and pledge the road for this purpose.[1]

But the legality of bonds issued under a charter power is no longer open to question after a special act has been passed, formally declaring them to be valid.[2]

So also certificates of organization under general laws sometimes contain such provisions. Thus, where such a certificate empowered a company in general terms "to issue bonds, . . . and to sell or pledge such bonds for proper corporate purposes," and the validity of the contract in pursuance of which they are issued is established, the question whether they shall be ordinary bonds, or income bonds, or simple debentures, is a matter of corporate regulation with which the courts will not interfere.[3]

§ 4. **General Statutory Provisions as to the Issue of Bonds.** — The principal statutory provisions of the different States relating to the issue of bonds by railway companies are not here tabulated, but the cases are cited which have construed such provisions.

The subjects dealt with in the provisions which have been construed may be conveniently reviewed under four heads: (*a*) The purposes for which bonds may be issued; (*b*) The consideration for which they may be issued; (*c*) The amount to which they may be issued; (*d*) The rate of interest for which they may be issued.[4]

(a) *Construction of Statutory Provisions specifying the Purposes for which Bonds may be issued.* — Statutory conditions as to the nature of the bonds to be issued as a security for the loan of the State credit must be strictly complied with to give the corporation a right to claim the benefits of the legislation. Where the legislature requires as a security for the loan of the State's credit by the issue of State bonds a deposit of corporate bonds which shall have forty years to run, without any qualification, the issue of corporate bonds containing a clause providing that the principal debt shall become immediately exigible is not such a compliance with the statute as will enable the corporation to compel the State officials to issue the State bonds.[5]

[1] Pennock *v.* Coe (1860), 23 How. 117.

[2] White Water Val. Canal Co. *v.* Vallette (1858), 21 How. 414 (1858).

[3] Willoughby *v.* Chicago Junction Railways, etc. Co. (1892), 50 N. J. Eq. 656; s. c. 25 Atl. Rep. 277.

[4] In the absence of some restrictive provision, the power to issue bonds for the purposes mentioned in an enabling statute may be exercised by the majority of the board of directors. McLane *v.* Placerville T. T. Vo. (1885), 66 Cal. 606; s. c. 26 A. & E. R. R. Cas. 404 (1885), construing the statutes of California (1861), § 15, as amended by the statute of 1862, § 547.

[5] State *v.* Nichols (1878), 30 La. Ann. Part 11, 1217. The court held that the insertion of such a clause was a departure

The rule that railway companies may issue bonds to carry into effect the purpose of their organization necessarily involves the proposition that such issue may be made in payment for work done and materials furnished in the construction of the road.

An issue of bonds which is not for the construction, equipment, or operation of the road, but, for instance, to pay the debts of another corporation, is void as against any holders with notice of the purposes of the issue.[1]

Bonds may be pledged as collateral upon an extension or renewal of the floating debt of a company, or to secure notes given in payment of unsecured bonds of the company.[2]

While a provision of the law of New York (Laws 1850, ch. 140, § 28, subd. 10), that railroad corporations could "from time to time borrow such sums of money as might be necessary for completing and finishing or operating their railroad, and issue bonds for the money borrowed, and secure their repayment by a mortgage upon the corporate property and franchises," may have been designed to carry with it an implication that mortgage bonds cannot be issued for any other purpose, it is competent for the legislature to remove such a restraint, and place it within the power of a consolidated road, as was done in a case by the act of 1869, ch. 917, § 2, prescribing terms and conditions for the consolidation. In such a case the consolidated company may issue bonds

from the terms presented by the legislature, which increased the liability of the State beyond the risk which it was intended to incur, the possible result of its enforcement being that the mortgaged property might be thrown upon the market at any time, however unpropitious, and the State thus deprived of the protection afforded by its own laws, which were designed to prevent any such sacrifices.

[1] City of Chicago *v.* Cameron (1887), 120 Ill. 447; s. c. 11 N. E. Rep. 899. As to the principle governing this decision see Pierce *v.* Madison & Indianapolis R. Co., 21 How. 441 (1858). In Thompson *v.* Erie R. Co. (1871), 42 How. Pr. 8, it was held that the issue of bonds for the purposes expressed in a mortgage, — which were "to consolidate its funded debt, obtain the money and material necessary for protecting its line of railway, enlarging its capacities, and extending the facilities thereof," — was within the power of the company. As to issuing bonds for the procurement of rails for its road, see Miller *v.* Rutland & Washington R. Co. (1863), 36 Vt. 452. As to the use of bonds in paying indebtedness growing out of the purchase of another road, or in constructing an unfinished portion of it, see McAllister *v.* Plant (1876), 54 Miss. 106.

A company organized under the Manufacturing Act of New York (Laws of 1848, ch. 40, § 5, as amended by Laws of 1881, ch. 213, § 5) has the power to borrow money for the purpose of constructing its works, and to issue bonds for its payment. This provision empowers such a company to purchase works already constructed, and fit and suitable for its purposes. Gamble *v.* Queen's County Water Co. (1890), 123 N. Y. 91; s. c. 25 N. E. Rep. 201; 31 Am. & Eng. Corp. Cas. 313.

[2] Claflin *v.* South Car. R. Co. (1880), 8 Fed. Rep. 118. See also as to other debts for which bonds may be pledged, Duncomb *v.* N. Y., Housatonic, & Northern R. Co. (1881), 84 N. Y. 190.

for the purpose of paying the liabilities of the constituent companies.[1]

As the law of New York (Laws 1850, ch. 140, §§ 14, 15) authorized a railroad corporation to acquire land for its track and other necessary purposes, by voluntary purchase or by condemnation, an agreement made on the purchase of rights of way to pay therefor in bonds of the purchasing corporation, secured by a mortgage on its property, was deemed by the New York Court of Appeals clearly within the implied, if not within the express, powers of a railroad corporation, as stated in sect. 28, subd. 10, of the Law of 1850.[2]

A railroad company, when not restricted by its charter, may acquire lands at its pleasure, and where it executes a mortgage to secure bonds to be used to raise money for construction purposes, may devote part of the bonds to the purchase of lands, to be utilized by including them in the mortgage, as additional security for all bonds.[3]

In the absence of some restriction in the charter, the salaries of the officers of the company, being a necessary part of the expenses of the construction of the road, may be paid with bonds used to raise funds for the construction.[4]

Where two companies were organized under the laws of Texas, and neither company had the power to extend its credit to foster the interests of the other, the issuance by the two companies of joint bonds, dividing the proceeds, was held equivalent to borrowing the money to be divided between them, each to be surety of the other; and, further, the bonds of the two companies would be binding on each to the extent of value received by it for which they had been issued.[5]

A company empowered to issue bonds to raise money for the

[1] Taylor *et al.* *v.* Trustees of Atlantic & Great Western R. Co. *et al.* (1878), 53 How. Pr. 26.

[2] Munson *et al.* *v.* Syracuse, Geneva, & Corning R. Co. *et al.* (1886), 103 N. Y. 58; s. c. 8 N. E. Rep. 355.

[3] Blackburn *v.* Selma R. Co. (1879), 2 Flip. 525.

[4] *Ibid.*

[5] Northside Ry. Co. *v.* Worthington, 88 Texas, 562 (1895). Where a company is formed to take over the business of a person, and agrees to indemnify him against his debts, an issue of debentures to pay those debts is valid, if the company is vested with a general authority to borrow or raise money by issuing debentures. Seligman *v.* Prince (C. A.), L. R. (1895), 2 Ch. 617. It was pointed out by Lopes, L. J., that no question could have been made as to the validity of the transaction, if the company, as they might have done, had issued the debentures to the owner of the business, as a part of the consideration for the purchase, and he had then raised the amount of the debt upon them, and handed it to the person now suing as the holder of the debentures. What had been actually done was practically the same thing done in a less circuitous manner.

construction of its road has the implied power to issue to the contractor, in payment for work done, negotiable certificates of indebtedness, payable in money or bonds.[1]

The Massachusetts statute of 1854, ch. 286, has had the effect of entirely abrogating the common-law power to issue bonds, so far as railroad companies are concerned, and any bonds issued for a purpose and in a manner not expressly authorized by the statute are absolutely void.[2]

(b) *Construction of Statutory Provisions as to the Consideration for Bonds.*—A statute of Ohio passed in 1820 (1 Swan & C. 862) was in force when the bonds of a railway company were issued. The statute provided "that all bonds, promissory notes, bills of exchange, foreign and inland, drawn for any sum or sums of money certain, and made payable to any person or order, or to any person or bearer, or to any person or assigns, shall be negotiable by indorsement thereon," etc. It was claimed that these railway bonds, though stated on their face to be transmissible by delivery, were not negotiable under this statute unless indorsed. The bonds were payable in New York city. The Supreme Court of Ohio held the bonds to be negotiable without indorsement.[3]

An hypothecation of bonds has been held to be an "issue" of

1 Pusey *v.* New Jersey R. Co. (1873), 14 Abb. Pr. (N. S.) 434.

2 Commonwealth *v.* Smith (1865), 10 Allen, 448 (1865).

This ruling of the Massachusetts court does not seem to have been overruled, but the Public Statutes upon the subject of bonds and mortgages have been altered very much since the act of 1854, and the powers of railroad companies as to the issue of bonds and execution of mortgages have been much enlarged. See Pub. Stats. Mass. (1882), 612, ch. 112, §§ 62–73, Acts 1874, 1875, 1876; and by Pub. Stats. Mass. (1882–1888), 502, ch. 191, Act 1887, April 15, the time for which such bonds may run has been extended from "twenty" to "fifty" years.

3 Pittsburgh, C. C., & St. L. Ry. Co. *v.* Lynde *et al.* (Ohio), 44 N. E. Rep. 596 (1896). The court, after referring to the fact that it had held, in deference to a long-continued practice, the indorsement to be unnecessary to the transfer of a promissory note (not under seal) payable to bearer, said: "We think the same considerations based on a similar long-continued practice in regard to railroad bonds, together with the express declaration of transmissibility appearing on the face of the bonds in controversy, and the manifest necessity of the quality of negotiability by mere delivery to their availability to accomplish the object expected of them, would require us to hold them to be negotiable by mere delivery even if of the opinion that they were sealed instruments according to the strict construction of that statute. . . . In the case of railroad or other corporate securities, however, the attaching of a corporate seal bears a strong analogy to the signature of a natural person, and is its substantial equivalent. In view of the vast sums of money represented by this class of securities, and of the existence of a practice of passing them from hand to hand by delivery, so universal and long continued as to be within the common knowledge of every one, they should not be shorn of this valuable attribute on this account, unless the words of the statute and the former decisions of the court imperatively require it."

bonds within the prohibition of the Wisconsin statute, providing that "no corporation shall issue any bonds . . . except for money, labor, or property, estimated at its true money value, actually received by it, equal to seventy-five per cent of the par value thereof." Bonds hypothecated without a stipulation that they shall be accounted for at not less than seventy-five cents on the dollar of their value are void.[1]

Under a constitutional or statutory provision which expressly forbids a company to issue bonds except for money paid, labor done, or property actually received, it cannot dispose of its bonds by pledging them for an antecedent debt.[2]

So under a statute authorizing the issue of bonds by a railroad company to an amount not exceeding the capital secured by mortgage of the property and franchises, such bonds cannot be issued otherwise than for a new adequate valuable consideration increasing the available funds of the corporation.[3]

A statute forbidding the issuance of bonds except for money, labor, or property received, is sufficiently complied with where the bonds are issued in payment for the construction of the company's road, and the amount of the issue does not unreasonably exceed the value received.[4]

Such a statute cannot be construed as indicating a purpose to make the validity of every issue of bonds dependent upon the inquiry whether the money, property, or labor actually received therefor was of equal value in the market with the bonds issued.[5]

Under a similar constitutional provision in Texas, it has been held that bonds sold at ninety cents on the dollar were not void, but were binding obligations to the extent of the money received. For the excess the company received nothing, either in money, labor, or property.[6]

Where a railroad is taken as the consideration of an issue of stock and bonds, the question whether there has been an over-valuation is to be determined with reference to its actual capacity

Pfister *v.* Milwaukee Electric Ry. Co. *et al.* (1892), 83 Wis. 86; s. c. 53 N. W. Rep. 27.

In Mowry *v.* F. L. & T. Co., 76 Fed. Rep. 45, the same statute was construed and held not to apply to a deposit of bonds under a reorganization agreement. See also Andrews *v.* Nat. Foundry Co., 76 Fed. Rep. 166.

[2] Farmers' Loan & Trust Co. *v.* San Diego Car Co. (1891), 45 Fed. Rep. 518; so construing the California Constitution, § 11, art. 12, and the corresponding provision of the Civil Code, § 359.

[3] Kemble *v.* Wilmington R. Co. (1878), 13 Phil. 469.

[4] Brown *v.* Duluth, M., & N. Ry. Co. (1893), 53 Fed. Rep. 889; s. c. 54 Am. & Eng. R. R. Cas. 219.

[5] Memphis & Little Rock Railroad *v.* Dow (1887), 120 U. S. 298.

[6] Northside Ry. Co. *v.* Worthington (1895). 88 Texas, 573. See also § 2, above, note "Texas."

to make net earnings at the time of the transaction, and not by the price originally paid for it.[1]

Under the law of Alabama, bonds issued by a railroad company, and taken in part payment by a construction company for the construction of its road, have been held not to be void where there was no over-valuation, and the circumstances indicated that there had been a fair exercise of judgment and discretion on the part of the railroad company, honestly directed to secure a substantial compliance with the law.[2]

Bonds issued for the purpose of constructing a road are not invalidated by the fact that the road could have been or was constructed for less than the amount of the bonds issued to pay therefor.[3]

(c) *Construction of Statutory Provisions limiting the Amount to which Bonds may be issued.*[4]—The execution by a company of a mortgage on its own real estate to secure bonds has been held to be a "transfer of real-estate securities," within the meaning of the Iowa statute (McClain's Code, § 1611), which provides that, without such transfer, the maximum of the corporate indebtedness shall not exceed two-thirds of its capital stock.[5]

Bonds of a railroad company in the hands of directors of the company, who had full knowledge that the bonds issued were in excess of the amount of stock actually paid, have been held by

[1] Grant *et al.* *v.* East & West R. Co. of Ala. *et al.* (1893), 54 Fed. Rep. 569, affirming Same *v.* Same (1892), 52 Fed. Rep. 531. A large number of cases are cited in the opinion as to payment for bonds in property.

If bonds are delivered in payment for work done and materials furnished, it is equally as good as if they had been sold for cash. See 7 Fed. Rep. 796 (1881).

[2] Coe *v.* East & West R. Co. *et al.* (1892), 52 Fed. Rep. 531.

[3] Farmers' Loan & Trust Co. *v.* Rockaway Valley R. Co. (1895), 69 Fed. Rep. 9.

[4] As to the rights of holders where there are contractual limitations on the issue, see Chap. II., Art. II.

[5] First Nat. Bank of Montpelier *v.* Sioux City Terminal R. & Warehouse Co. (1895), 69 Fed. Rep. 441.

The same case holds that the provisions of the same section, that the real estate thus transferred shall be "unincumbered," is sufficiently complied with where the property is a terminal station and warehouse, although it has previously been leased to a railroad company. The ground taken by the court was that the terminal property was of no value unless leased to a transportation company, and that the lease of the property was actually the only means by which it could be made to serve as a security for the bonds. See Fidelity, etc. Co. *v.* West Penn., etc. R. Co. *et al.* (1891), 138 Pa. St. 424; s. c. 21 Atl. Rep. 21, to an amount where a company had issued bonds more than twice the amount of the capital stock paid in, and executed a mortgage to secure them in contravention of the act of April 4, 1868, P. L. Pa. 62. The court reaffirmed Reed's Appeal (1888), 122 Pa. St. 565; s. c. 16 Atl. Rep. 100, holding that the mortgage was unauthorized, and might be held inoperative and void as to parties having the right to complain, but, as between *bona fide* holders of the mortgage bonds and the company, the mortgage was a lien upon the mortgaged property.

the Court of Errors and Appeals of New Jersey to be invalid and worthless.[1]

But where such pass in good faith to third parties, who have no knowledge of their being a part of an over-issue, or the real over-issue of the bonds occurs subsequently to their obtaining title to them, the rule is different, and they will be entitled to be paid.[2]

§ 5. **Rate of Interest at which Bonds may be issued.** — That the statutes regulating the rate of interest on bonds do not apply to bonds issued under reorganization agreements, see Chap. XXXVII., *post.*

In determining how far bonds shall be invalidated for the reason that they reserve more than the legal interest, the essential point is upon the question as to the laws of what State was the contract entered into. The usual presumption is that the State is the one where the corporation has its legal home, and this presumption is not rebutted by the fact that the interest is made payable in another State, the arrangement being regarded as one merely for the convenience of coupon-holders, and not as having the effect of bringing the contract under the familiar qualification of the general rule, viz., that the law of the place of performance yields to the law of the place of the contract. Thus where a Vermont railroad company issued bonds, the interest on which was to be paid in Boston, it was held that, as the parties had apparently contracted with special reference to the law of Vermont, and made the interest payable at Boston merely because it was a financial centre, the contract was governed by that law, by which the result of stipulating for a usurious rate of interest was not to vitiate the obligation, but to disable the creditor from collecting more than the legal rate.[3]

[1] Steelman *et al.* *v.* Baker (N. J., 1896), 33 Atl. Rep. 815. P. L. N. J., 1878, p. 20, ch. xii., § 20, limits the issue of bonds of railroad companies to the amount of their paid-up capital stock. See Nowell *v.* Andover & Redbridge R. Co., 7 Jur. N. S. Ch. 839.

[2] Physick *et al.* *v.* Baker (N. J., 1896), 33 Atl. Rep. 815.

[3] Codman *v.* Vermont & C. R. Co. (1879), 16 Blatchf. 165, 177; S. C. 5 Fed. Cas., Case No. 2935, following Cheever *v.* Rutland & Burlington R. Co. (Vt., 1869); S. C. 4 Am. Ry. Rep. 291.

In Commrs. of the County of Craven *v.* Atlantic & N. C. R. Co. (1877), 77 N. C. 289, the bonds were payable in New York, and an attempt was made to avoid the effect of usury in these bonds by pleading the statute of New York, which forbids corporations pleading usury as a defence. The court, however, held that as North Carolina was the State where the work was done, and the bonds given in payment for the work, and where the property mortgaged as security was situated, and where payment could be enforced, the laws of the latter State as to interest governed.

When bonds are payable in a State where corporations cannot interfere, the defence of usury, unless the place mentioned is adopted as a shift or device to avoid the statute of usury, such a defence will not avail. See 12 Wall. 276 (1870).

(a) *When an Issue of Bonds is usurious.* — A railway corporation cannot legally sell its bonds bearing the highest legal rate of interest at a discount for the purpose of borrowing money. Such a sale would be in effect a loan and a usurious transaction.[1]

(b) *When an Issue of Bonds is not usurious.* — It has been held that a usury law has no application in a case where the transaction is in effect an issue of bonds to pay for the completion of a road, although the transfer is styled a loan by the parties, and although the sum for which the bonds are issued is largely in excess of the estimated cost of the work.[2] In many States there are statutes authorizing railroad companies to borrow money and sell their securities at any rate of interest or price they may deem proper, and it has been said that a company is at liberty to sell its bonds at any price it pleases, unless prohibited by statute (see 13 Fed. Rep. 524).

A statute authorizing railroad companies to sell their bonds and notes at such prices as they may deem expedient justifies a sale of such bonds at less than their par value.[3]

So a charter authorizing the company to borrow money "in such terms as might be agreed upon between the parties" empowers them to borrow money at a rate of interest beyond that established by the general law.[4]

So a charter which declares that a corporation may borrow money on such terms as the directors may determine upon, and may issue bonds or other evidences of indebtedness, authorizes the corporation to sell its bonds below their face value, and where it does so the loan is not usurious.[5]

Wherever the Statute of Usury has been repealed, no objection can be raised as to the validity of bonds on the score of their having been negotiated at less than par.[6]

[1] Commrs. of the County of Craven *v.* Atlantic & N. C. R. Co. (1877), 77 N. C. 289; West Cornwall Ry. Co. *v.* Mowatt, 17 L. J. Ch. 366; *In re* Regent's Canal Ironworks Co., 3 Ch. Div. 43; *In re* Anglo-Danubian, etc. Colliery Co., 20 Eq. 339; *In re* Compagnie Générale de Bellegarde, 4 Ch. Div. 470.

[2] White Water Val. Canal Co. *v.* Vallette (1858), 21 How. 414.

[3] Junction Railroad Co. *v.* Bank of Ashland (1870), 12 Wall. 226.

[4] Morrison *v.* Eaton & Hamilton R. Co. (1860), 14 Ind. 110, an action on a note of the company. See Butler *v.* Edgerton, 15 Ind. 15; Butler *v.* Myer, 17 Ind. 77.

[5] Traders' National Bank *v.* Lawrence Manufg. Co. (1887), 96 N. C. 298; s. c. 3 S. E. Rep. 63.

As to the issuing of bonds convertible into stock, and a statute prohibiting a sale of stock below par, see Sturges *v.* Stetson (1858), 1 Biss. 246; Fosdick *v.* Sturges (1858), 1 Biss. 255.

[6] Gamble *v.* Queen's Co. Water Co. (1890), 123 N. Y. 91; s. c. 25 N. E. Rep. 201; 32 Am. & Eng. Corp. Cas. 313; Stevens *v.* Watson (1865), 4 Abb. App. Cas. 202; Rosa *v.* Butterfield (1865), 33 N. Y. 665. See N.Y. Laws, 1850, ch. 172.

Bonds are not invalidated by the fact that the company is empowered to issue them at a certain rate of interest, and stipulates that the interest shall be paid

A statute of Arkansas provided that "Whenever any railroad company . . . shall, in the opinion of the directors thereof, require an increased amount of the capital stock, . . . they shall have power to borrow money . . . at a rate of interest not exceeding seven per cent per annum . . ." There was a suit to foreclose a mortgage securing bonds issued bearing 10 per cent interest, as agreed upon in a plan of reorganization. It was contended that these bonds were void, having been issued at a rate of interest greater than that allowed in the above-mentioned act. The court sustained the validity of these bonds against this contention by simply saying that this statute had no application to the case, for there was here no increase of the existing capital stock of a corporation. This new railway company had acquired the ownership of the interests in question upon terms and conditions, and this statute was no obstacle to its full performance of those terms and conditions.[1]

Where a legislature authorizes the indorsement by the State of bonds of a railroad company bearing interest at 8 per cent per annum, the fair construction is that it means 8 per cent in any legal-tender currency on which the parties may agree.[2]

Bonds stipulating for semi-annual payments of interest, and that, in default of the reasonably prompt payment of interest as it should accrue, the principal sum might be treated as due and payable, are not invalid because the provisions of the act authorizing their issue are that the bonds shall bear a rate of interest not exceeding 8 per cent per annum, and have no longer than thirty years to run.[3]

§ 6. **Power to issue Bonds after Consolidation.** — The general rule that a consolidated company acquires the charter powers, privileges and immunities of the constituent companies[4] is applicable to the power to issue bonds.[5]

semi-annually. Coe *v.* Columbus, P. & R. Co. (1859), 10 Ohio St. 372.

[1] Memphis & Little Rock Railroad *v.* Dow (1887), 120 U. S. 300.

[2] Young *v.* Montgomery & Eufaula R. Co. (1875), 2 Woods, 614.

[3] Newport & Covington R. Co. *v.* Douglass (1877), 12 Bush (Ky.), 673; s. c. 18 Am. Ry. Rep. 221.

In Campbell *v.* Tex. & New Orleans R. Co. (1872), 2 Woods, 263, bonds of a railroad company which, by the authority of the statutes were to bear 6 per cent interest, were issued to bear 8 per cent interest. They were ordered to be paid with a priority only to the extent of 6 per cent interest. The bonds to be given the State for the loan of the School Fund were to run ten years, and a sinking fund was to be provided for their payment. As issued they were to run fifteen years, and no sinking fund was required to be set apart for their payment. The court held that these circumstances were not of the essence of the contract, and that the legislation authorizing the changes did not impair the obligation of the contract contained in the original first mortgage.

[4] Thompson on Corp., § 365.

[5] See, for example, Coe *v.* New Jersey Midland Ry. Co. (1879), 31 N. J. Eq. 105.

The legislature of Connecticut pro-

When several years have elapsed since the consolidation of two companies, and the issue of bonds by the consolidated company, a stockholder will not be permitted, as against *bona fide* holders of such bonds, to raise the objection that they are invalid for the reason that the consolidation was illegal.[1]

§ 7. **Validity of Bonds.** 1. *Miscellaneous Cases.* — An issue of bonds in payment for the construction of a railroad will not be invalidated by the fact that the railroad could have been, or was, perhaps, built and constructed for less than the amount of the bonds which were issued to pay for it; especially is this true where there is no charge of fraud in the inception or execution of the contract for the construction of the railroad.[2]

It is no more competent for stockholders than for a company to question the authority of contracts of consolidation or the execution of mortgages, after the lapse of several years and the sale of bonds to *bona fide* purchasers on the faith of such contracts.[3]

Where a railroad company, incorporated in and under the laws of one State, enters into a contract in another State, which, by its terms, is to be performed in the latter State and is valid under its laws, prohibitions in the corporate charter, which would render the contract illegal in the State where the corporation was organized, do not render it illegal in the other State; their only effect in the other State is as restrictions on the corporate power. Thus, although a law of the State where the corporation was organized may have positively forbidden the sale of its bonds at less than par, yet if the bonds are issued and sold in another State, and the interest and principal are both payable there, the courts of the

vided that, whenever a certain railroad company owning a road lying partly within that State should be consolidated with any other company in the State of New York in pursuance of the laws of the latter State, the new company should have all the rights within the State of Connecticut that were possessed by the old. In a case involving the power of the consolidated corporation, the existence of which had been recognized by an act subsequently passed by the New York legislature, it was held that this act validated and established the agreement under which the consolidation was made, and that, when the legal existence of the new corporation in the State of New York became thus established, it satisfied the requirements of the Connecticut act, and the new company became possessed of all the rights in Connecticut which had been possessed by the old company, succeeding to the power possessed by the old company in both States to issue its bonds to an amount necessary for completing its road, and to mortgage its property and franchises for their security. Mead *v.* New York R. Co. (1879), 46 Conn. 199; s. c. 17 Am. Ry. Rep. 367. As to bonds given for the purchase price of the road, see Holland *v.* Lee, 71 Md. 338; s. c. 18 Atl. Rep. 661.

[1] Dimpfel *v.* Ohio & M. Ry. Co. (1879), 9 Biss. 127.

[2] Farmers' Loan & Trust Co. *v.* Rockaway Valley R. Co. *et al.* (1895), 69 Fed. Rep. 9.

[3] Dimpfel *v.* Ohio & M. Ry. Co. (1879), 9 Biss. 127.

latter State in passing upon the rights of a *bona fide* holder of the bonds will test the validity of the issue by the local law.[1]

A foreclosure sale, in proceedings instituted by the holders of railroad bonds, in a State where such bonds are valid, will be treated as null and void in the courts of another State in which their issue is unconstitutional and contrary to public policy. In such a case a decree in the first State is not binding upon the courts of the second, and the sale will be ineffective to pass the title to that portion of the corporate property which is situated in the latter.[2]

But such a sale will be recognized by the second court, if a part of the bonds are valid, for the invalidity of the remainder cannot then affect the validity of the foreclosure proceedings.[3]

Bonds executed in proper form and according to legal requirements for sale by a railroad company have no validity until delivered by the company.[4]

In Sickles *v.* Richardson the court held that bonds never delivered in the course of business, and levied upon and sold to satisfy a judgment, were invalid; that no title passed by the sale to the purchaser. It was held, however, that bonds of the same class pledged for advances made were valid bonds, as there had been in such a case a delivery; further, the pledgee, though a purchaser of the bonds, as claimed by other bondholders at a sale under execution, had at least a title which would require the company to redeem his bond by payment of the sums for which they were pledged, in order to divest his title.

The Supreme Court of Illinois have sustained the validity of bonds issued and sold by a railroad company, where the proceeds of the sale were used in the legitimate construction of its road, as not in contravention of the constitutional provision of that State as to what bonds should be issued for.

The court held that this provision was never intended to limit the issue of bonds by a railroad company to such only as would be in payment for an existing obligation for money, labor, and

[1] Ellsworth *v.* St. Louis, Alton, & Terre Haute R. Co. (1885), 98 N. Y. 553; Bank of Ashland *v.* Jones, 16 Ohio St. 145.

[2] Appeal of State Line R. Co. (1886), 1 Ry. & Corp. L. J. 139 [Penn. Common Pleas; case affirmed on appeal by the Supreme Court without discussion]. The constitutional provision infringed by the issue of these bonds was that relating to the "increase of indebtedness" without the consent of the stockholders (act of April 18, 1874).

[3] Rothschild *v.* Rochester R. Co. (1887), 1 Ry. & Corp. L. J. 321.

[4] Sickles *v.* Richardson (1881), 23 Hun, 559. See also Coddington *v.* Gilbert (1858), 17 N. Y. 489; Cunningham *v.* Penn., Slatington, & N. E. R. Co., 11 N. Y. St. Rep. 663.

property actually received and appraised for the purposes of the company.[1]

Bonds taken as a bonus on stock subscriptions by directors of a company, in their own hands or the hands of others, or pledgees, have been held not to be valid claims on a fund for distribution after a foreclosure sale.[2]

Bonds of a railroad company are not rendered void because of being secured by a mortgage which the company may have had no authority to execute, neither does the illegality of the rate of interest avoid a bond. It is good for the sum actually loaned with the legal rate of interest.[3]

All bonds issued by railroad companies except for the purposes and in the mode authorized by the statute of Massachusetts upon that subject have been held to be void.[4]

A railroad company has been held not liable even to a *bona fide* purchaser of a stolen bond which lacked the seal of the company and a certificate of the trustees when stolen, but to which a seal and certificate had been affixed and inserted which were shown to be forged.[5]

1 Peoria & Springfield R. Co. *v.* Thompson (1882), 103 Ill. 117; s. c. 7 Am. & Eng. R. R. Cas. 101. As to validity of bonds not being affected by conditions precedent not having been substantively fulfilled, see Corp. of Quebec *v.* Quebec C. Ry. Co., 10 Can. S. C. Rep. 563; Bickford *v.* G. J. Ry. Co., 1 Can. S. C. Rep. 696. See Union Trust Co. *v.* Nevada & O. R. Co., 10 Sawy. 122.

2 Duncomb *v.* New York, Housatonic, & Northern R. Co. (1881), 84 N. Y. 190; s. c. 4 Am. & Eng. R. R. Cas. 293.

In McKee *v.* Grand Rapids & Reed's Lake Street Ry. Co. (1879), 41 Mich. 274, bonds meant only to be sold in open market which had been turned over to a mortgagee (who knew they had never been sold), as collateral security for the private debts of the treasurer of the company, who had a controlling interest in its property, without authority from, or ratification by, the corporation. As against a judgment creditor of the corporation, these bonds were held not to have been properly issued and to be invalid, so far as to prevent giving the mortgagee priority of lien over the levy of the execution of the judgment creditor.

3 Philadelphia & Sunbury R. Co. *v.* Lewis (1859), 33 Pa. St. 33; Wood *v.* Whelen (1879), 93 Ill. 153; Beecher *v.* Marquette & Poe Rolling Mill Co. (1881), 45 Mich. 103.

In Jesup *v.* City Bank of Racine (1861), 14 Wis. 331, bonds and mortgage were held valid except as to a provision "that the principal sum should become due at the option of the holder upon default in the payment of interest," inserted in the bonds and mortgage by the president of the company, without corporate authority, upon the rule that where an agent adds something beyond his authority, the excess will not invalidate that which may well stand without it.

If there was want of authority originally to issue these bonds with a provision changing the time of maturity from fifteen years to the option of the holders upon default, and the board of directors had ratified it, that would have rendered them valid. But in this case the president may have relied on his general authority as agent to dispose of all securities, and, if so, that would have been no ratification.

4 Commonwealth *v.* Smith (1865), 10 Allen, 448. (See above, § 4 (*a*).)

5 Maas *v.* Missouri, K. & J. Ry. Co. (1880), 83 N. Y. 223; s. c. 3 Am. & Eng.

(2) *Holders' Rights though Bonds are void.* — The holders of bonds which had been declared void in this case on account of the construction company to which they were issued having some of the directors of the railroad company as members of its board of directors, were held entitled to a decree of payment of the sums actually expended for construction under this contract.[1]

The invalidity of some of the bonds issued by a railroad company secured by a mortgage cannot affect the validity of the mortgage or the validity of proceedings for its foreclosure.[2]

(3) *Burden to show Validity or Invalidity.* — Where railroad bonds are valid on their face, the burden is not upon the holder to show that the provisions of law authorizing their issue have been complied with, but upon the party claiming them to be invalid to show their invalidity. In the case cited there was no ground for claiming that the bonds were not issued in accordance with the charter, and without regard to the amount expended and the sworn statement of the engineer. There was no proof on the trial that there was any failure in this respect; the plaintiff was held not bound to prove that these provisions of the law were complied with.[3]

Nor may it be shown against *bona fide* holders of bonds issued by a railroad corporation that restrictions imposed by its charter upon the power to negotiate its bonds were violated. Such corporations having general power to issue bonds, persons dealing therein, in the absence of notice, have the right to assume that

R. R. Cas. 30, affirming Same *v.* Same (1877), 11 Hun, 8. See Wylie *v.* Missouri Pac. R. Co., 41 Fed. Rep. 623; s. c. 43 Am. & Eng. R. R. Cas. 431.

See as to the effect of numbers of bonds in determining the validity or invalidity of the bonds where there is an over-issue. State *ex rel.* Plock *v.* Cobb (1879), 64 Ala. 127; s. c. 7 Am. & Eng. R. R. Cas. 147. See as to validity of bonds issued by a consolidated railroad company for the bonds of its constituent companies, Taylor *v.* Atl. & Great Western R. Co. (1878), 57 How. Pr. 26. See as to validity of bonds, Rorer on Railroads, 252; Redfield Am. Ry. Cases, 588. See as to the constitutional provisions of Pennsylvania requiring the assent of stockholders not invalidating bonds issued as collateral security for a prior indebtedness of a railroad company, Rothschild *v.* Rochester & Pittsburg R. Co. (1887), 1 Ry. & Corp. L. J. 321, reversing appeal of State Line R. Co. (1880), 1 Ry. & Corp. L. J. 139. See as to validity of bonds sold to a syndicate of which the directors of the company were members under Ohio statutes, Union Trust Co. *v.* New York C. & S. L. R. Co. (1886), 1 Ry. & Corp. L. J. 50.

[1] Thomas *v.* Brownville, Fort Kearney, & Pac. R. Co. (1883), 109 U. S. 522. On the question whether money received by a company on a pledge of void bonds must be restored, see Andrews *v.* National Co., 76 Fed. Rep. 176.

[2] Graham *v.* Boston, Hartford, & Erie R. Co. (1886), 118 U. S. 61.

[3] Nichols *v.* Mase (1883), 94 N. Y. 160; s. c. 17 Am. & Eng. R. R. Cas. 230, affirming Same *v.* Same (1881), 25 Hun, 640; see also Heinshiemer *v.* Dayton R. Co. (1888), 3 Ry. & Corp. L. J. 268.

all restrictions upon the power to issue have been complied with.[1]

(4) *Estoppel.* — Junior mortgagees and all parties claiming under them are estopped from questioning the validity of bonds issued under a former mortgage, where the subsequent mortgage is made in express terms subject to the bonds secured by this former mortgage. The company can thus waive objections to their validity.[2]

So, general creditors of a railroad company who had given credit, after notice of a prior issue of bonds, and execution of a mortgage, have been held to be in the position of the company and estopped to deny the validity of the bonds and mortgage, on the ground that the company had issued bonds to an amount more than double the amount of paid-up stock, — an act which was *ultra vires*, it being positively prohibited by the laws of the State.[3]

Upon a contention that, as the bonds of a railroad company which were to be exchanged for State bonds were fraudulently issued by the officers of the company, and the issue of the State bonds was unconstitutional, the bondholders could therefore receive from the company only the amount they paid for them, the Supreme Court of the United States held that the bonds, though void as to the State, were valid as to the company which sold them; that having been put upon the market as valid bonds, the companies were estopped from setting up their unconstitutionality.[4]

[1] Ellsworth *v.* St. Louis, Alton, & Terre Haute R. Co. (1888), 98 N. Y. 553, affirming Same *v.* Same (1884), 33 Hun, 7.

[2] Bronson *et al.* *v.* La Crosse & Milwaukee R. Co. *et al.* (1863), 2 Wall. 283.

[3] Fidelity, etc. Co. *v.* West. Penn., etc. R. Co. (1891), 138 Pa. St. 494; s. c. 21 Atl. Rep. 21. See also Reed's Appeal (1883), 122 Pa. St. 565; s. c. 16 Atl. Rep. 100; Graham *v.* Railroad Company (1880), 102 U. S. 148.

As to estoppel of a company to claim that its bonds were invalid as having been issued in contravention of a statute limiting them in amount to the amount of its capital stock, see Farmers' Loan & Trust Co. *et al.* *v.* Toledo, A. A. & N. M. Ry. Co. *et al.* (1895), 67 Fed. Rep. 49, which cites to the same point Allis *v.* Jones, 45 Fed. Rep. 148; Wood *v.* Waterworks Co., 44 Fed. Rep. 146; Water Company *v.* DeKay, 36 N. J. Eq. 548.

[4] Railroad Companies *v.* Schutte (1880), 103 U. S. 118, 144.

In Kelly *v.* Trustees, etc. (1877), 58 Ala. 489; s. c. 21 Am. Ry. Rep. 138, it was held that although railroad bonds were indorsed by the State in contravention and fraud of the internal improvement law of the State, and the indorsement, by reason thereof, was void, the corporation would not be relieved of its liability for such bonds which it had secured by a deed of trust upon its property. In Tyrell *v.* Cairo & St. Louis R. Co. (1879), 7 Mo. Ap. 294, the defence of *ultra vires* was held not to be available against holders for value of negotiable bonds issued by the directors of the corporation where the stockholders failed to take any steps to repudiate the action of the directors, and, to the contrary, allowed the bonds to be sold, and availed themselves of the benefit thereof. In Chicago

Even if an issue of bonds be entirely void, as being in violation of an express statutory provision limiting the amount of the issue to double the amount of capital stock paid in, general creditors who give credit to the company with full notice of the execution of the mortgage and the negotiation of the bonds must be regarded as having elected to do so subject to the earlier lien, and will, therefore, be postponed to the bondholders in the distribution of the proceeds to the extent of the money actually received by the company from the sale of the bonds.[1]

The holder of bonds is not estopped to set up the invalidity or want of consideration of bonds other than those he holds.[2]

(5) *Lack of Certification of Bonds.* — The point has been taken that if bonds do not have the certificate of the trustee to their genuineness, as required by the mortgage, they are void. But this was connected with notice of their invalidity, and without having parted with value for them.[3]

Bonds of a railroad company issued without any authority existing in the officers who issued them, by virtue of a specific vote previously passed or existing at the time of their issue, in payment of and allowed toward liabilities of the company, were held, by the Maine Supreme Judicial Court, cured of the effects of this irregularity by the company's subsequent action approving and ratifying the unauthorized acts of its officers.[4]

(6) *Ratification of Bonds.* — Certain bonds of a railroad company were held to be valid except as to a provision inserted with-

D. & V. Ry. Co. *et al.* *v.* Loewenthal (1879), 93 Ill. 433, it was held that where the proof clearly showed that the railway company never received any consideration for bonds issued by it to the payee, a contractor, which bonds were secured by a mortgage on its road, this would constitute a good defence against the payee or person to whom delivered, and as against a *bona fide* purchaser when seeking to foreclose the mortgage in a court of equity. How far binding on company in hands of *bona fide* purchasers, see Hebberd *v.* Southwestern Land & Cattle Co. (N. J. Eq.), 36 Atl. Rep. 122.

[1] Fidelity, etc. Co. *v.* Western Penn., etc. R. Co. (1891), 138 Pa. St. 494; s. c. 21 Atl. Rep. 21.

[2] Farmers' & Merchants' Bank *v.* West Electric Ry. & Light Co. (Tex., 1896), 36 S. W. Rep. 131.

A bondholder cannot defend a foreclosure suit on the ground that some of the bonds were without consideration because the railroad could have been, or perhaps was, built and constructed for less than the amount of the bonds issued; but he can raise the question as to whether any part of the bond issue was fraudulent before the master on the distribution. Farmers' Loan & Trust Co. *v.* Rockaway Valley R. Co. (1895), 69 Fed. Rep. 7, 11. See also Farmers' Loan & Trust Co. *et al.* *v.* Toledo, A. A. & N. M. Ry. Co. *et al.* (1895), 67 Fed. Rep. 49, where the decree of foreclosure expressly provided that the bonds might be attached as fraudulent on the distribution.

[3] Chicago, St. Louis, & New Orleans R. Co. *v.* Macomb (1880), 2 Fed. Rep. 18, Choate, D. J.

[4] Mason *v.* York & Cumberland R. Co. (1861), 52 Me. 82.

out authority. If the board of directors had subsequently ratified the bonds as issued, that would have rendered them valid as to all their provisions.[1]

In so far as the validity of the bonds is dependent upon the regularity of the proceedings incident to the issue of bonds, the case is obviously one where the principle *omnis ratihabitio retrotrahitur, et mandato priori æquiparatur* is applicable. Thus any invalidity arising from a want of original authority in the directors is cured by the subsequent recognition of their binding effect at annual meetings of the company, and its payment of the interest upon the indebtedness.[2]

§ 8. **Objections to the Validity of the Bonds on the Ground of the Relations of the Purchasers to the Corporation.** — A sale of bonds to a director of the company issuing them cannot be impeached by the corporation, where the director has paid full value for the bonds, and the money has been received and appropriated to corporate uses, with the knowledge and approval of the stockholders.[3]

Neither will bonds issued by a railroad company to a construction company be rendered void by the fact that all the stockholders of the one company were also stockholders of the other, or by the fact that the two corporations have substantially the same directors who were the active agents in negotiating the contract.[4]

So where a contract is made whereby a person controlling the board of directors is to receive in bonds the full value of property conveyed to a corporation, such bonds being secured by a mortgage on the same property, and also a large amount of the stock of the company for which no consideration is received by

[1] Jesup *v.* City Bank of Racine (1861), 14 Wis. 331. See Stainback *v.* Junk Bros.' Lumber & Mfg. Co. (Tenn., 1897), 39 S. W. Rep. 530; Quebec *v.* Quebec C. Ry. Co., 10 Sup. Ct. Rep. (Can.) 563.

[2] Farmers' Loan & Trust Co. *v.* Toledo, A. A. & N. W. R. Co. (1895), 67 Fed. Rep. 49; Mason *v.* York & Cumberland R. Co. (1861), 52 Me. 82.

[3] Union Loan & Trust Co. *v.* Southern Cal. Motor Road Co. (1892), 51 Fed. Rep. 840.

[4] Coe *v.* East & West R. Co. of Ala. (1892), 52 Fed. Rep. 531, citing several decisions of the U. S. Supreme Court.

The court said that such a contract "should not be set aside on technicalities, but only in case of palpable intended violation of the law, if it has inured to the benefit of the railroad company, and was the best available method for securing the construction of the road, and there was no palpable over-valuation of the work performed and moneys advanced, nor under-valuation of the stock and bonds received in payment." Compare Van Cott *v.* Van Brunt (1880), 82 N. Y. 535; Barr *v.* New York, L. E. & W. R. Co. (1891), 125 N. Y. 263; s. c. 26 N. E. Rep. 145, referred to with approval by the court. See Buffalo L. T. & S. D. Co. *v.* Medina Gas & E. L. Co., 42 N. Y. Supp. 781, where bonds were held valid though negotiated by an officer other than the one designated in the resolution authorizing them.

the corporation, the bonds issued in pursuance of the contract will be void, except as against *bona fide* purchasers.[1]

Bonds given to a director as a mere bonus on his subscribing to the stock are without consideration. The director, being a trustee of the company, has no right to receive the bonds, and in his hands they are void.[2]

Where a board of directors pass a resolution reciting authority in the president and secretary to issue bonds, the receipt of a bid for the bonds from them as individuals, and the acceptance of the bid, and the bonds are then delivered to a person as security for a claim against the president and secretary individually, such person is not a *bona fide* purchaser acting in reliance on such resolution.[3]

§ 9. **Informality of Issue, when this is an Objection of which only Corporations can take Advantage.**[4] — Although a statute declares that the proceedings at a meeting of the stockholders shall not be "of any force or effect" unless certain formalities are observed in advertising the meeting, it is only the stockholders themselves who can raise any question as to the validity of bonds issued at a meeting held without the exact notice required by the statute. The right of a holder of the bonds cannot be contested by the grantee of the parties who purchased the corporate property at an execution sale.[5]

§ 10. **When the Company is estopped to dispute the Validity of Bonds.** — It is a familiar rule that a corporation cannot reap the benefit of a loan, and then refuse to repay it on the plea that it had no power to borrow the money.[6]

[1] Central Trust Co. *v.* New York R. Co. (1886), 18 Abb. N. C. (N. Y.) 381.

[2] Duncomb *v.* New York R. Co. (1881), 84 N. Y. 190, 203; 4 Am. & Eng. R. R. Cas. 293.

[3] Germania Safety Vault & Trust Co. *v.* Boynton (1896), 71 Fed. Rep. 797. See also Steelman *v.* Baker, *supra*, § 4 (*c*).

But where a first issue of bonds is valid, and afterwards such bonds become the property of directors, who subsequently become charged with a knowledge that a later issue of bonds was not upon a paid-up stock basis, it was held that the first issue was valid, and that in a suit to have the mortgage declared void the bonds could not be taken from them either as a penalty, or as a contribution to the general dividend fund for the holders of subsequent issues. Physick *v.* Baker (1895), 53 New Jersey Eq. 673; s. c. 33 Atl. Rep. 815.

[4] Compare Chap. VII.

[5] Beecher *v.* Marquette & Pac. Rolling Mill Co. (1881), 45 Mich. 103.

[6] North Hudson Mut. B. & L. Assn. *v.* First Nat. Bank (1891), 79 Wis. 31; s. c. 47 N. W. Rep. 300, citing the following cases: Ohio & M. Ry. Co. *v.* McCarthy, 96 U. S. 258; Whitney Arms Co. *v.* Barlow (1875), 63 N. Y. 62; Union Water Co. *v.* Murphy's Flat Flume Co. (1863), 22 Cal. 620; Sussex R. Co. *v.* M. & E. R. Co. (1868), 19 N. J. Eq. 13; Close *v.* Glenwood Cemetery, 107 U. S. 466; Shrewsbury Ry. Co. *v.* London Ry. Co., 16 Beav. 441; Auerbach *v.* Le Sueur Mill Co. (1881), 28 Minn. 291; Wright *v.* Hughes (1889), 119 Ind. 324; Jones *v.* Nat. Bldg. Assn., 94 Pa. St. 215; Williams *v.* Stevens Point Lumber Co., 72 Wis. 487; s. c. 40 N. W. Rep. 154; Manuf. L. Co. *v.* Conover, 5 Phil. 18.

This rule operates for the benefit of bondholders. Thus, where all the stockholders agree to an issue of bonds, knowing that the amount authorized is beyond that permitted by the law, the corporation cannot, after having received and enjoyed the fruits of the bonds, assail their validity in the hands of *bona fide* holders on the ground that the issue was in excess of the statutory amount.[1]

A company could not be allowed to disavow and repudiate its own acts to the injury of *bona fide* holders of its bonds without notice, where the trust deed and bonds had been executed with all the legal formalities required by the company's charter, and the bonds negotiated in open market, the proceeds of the sale paid to it, and appropriations made by it to pay the interest.[2]

Compare Reed's App. (1888), 122 Pa. St. 565; Fidelity, etc. Co. *v.* Western Penn., etc. R. Co. (1891), 138 Pa. St. 494.

[1] Wood *et al.* *v.* Corry Waterworks Co. *et al.* (1890), 44 Fed. Rep. 146.

[2] Harrison *v.* A. & E. R. Co. (1878), 50 Md. 490.

Where a company have power to issue securities, an irregularity in the issue cannot be set up against even the original holder if he has a right to presume *omnia rite acta.* Fountaine *v.* Carmarthen Ry. Co., L. R. 5 Eq. 316; Jones *v.* Municipality, etc., 20 N. B. 78; 21 N. B. 200; *In re* Farlinger, etc., 16 Ont. Rep. 722; Lewis *v.* Brady, 17 Ont. Rep. 377; Township, etc. *v.* Toronto & N. Ry., 17 Grant Ch. 425; Anderson *v.* Gold Mine Co., 1 Australian Jurist, 161; *In re* Worcester Exchange, 3 De G., M. & G. 180; *In re* Tyson's Reef Co., 3 W. W. & A. B. Cas. at Law, 162; G. T. Ry. Co. *v.* Corporation, etc., 10 R. L. 612; Bank *v.* Cheney, 15 Up. Can. Q. B. 400; Hampshire Land Co., *In re*, Portsea Island Building Soc., *Ex parte* (1896), 2 Ch. 743; Hill *v.* Manchester & Salford Waterworks Co., 2 B. & Ad. 544; *In re* German Mining Co., 4 De G., M. & G. 19; *In re* Magdalena St. Nav. Co., Johns. 690; Baker's Case, 1 Dr. & Sm. 55; Troup's Case, 29 Beav. 353; Hoare's Case, 30 Beav. 225; Pare *v.* Clegg, 29 Beav. 589; Agar *v.* Athenæum Life Ass. Soc., 6 W. R. 277.

If such security be legally transferable, such an irregularity, and, *a fortiori*, any equity against the original holder, cannot be asserted by the company against a *bona fide* transferee for value without notice. Webb *v.* Commissioners of Herne Bay, L. R. 5 Q. B. 642.

Nor can such an equity be set up against an equitable transferee, whether the security was transferable at law or not, if, by the original conduct of the company in issuing the security, or by the subsequent dealing with the transferee, he has a superior equity. *In re* Agra & Masterman's Bank, L. R. 2 Ch. 391; *In re* Blakely Ordnance Company, L. R. 3 Ch. 154; Dickson *v.* Swansea Vale and Neath & Breem Junction Ry. Co., L. R. 4 Q. B. 44.

In the winding up of a canal company under the English laws, the claims were as follows: C. claimed as the transferee of debentures for value of Y., a sub-contractor, to whom the contractor had transferred them for a nominal consideration. P. claimed on debentures deposited as security of a bill against the contractor due Y., which he had discounted. These debentures were not transferred to P., and the transfer to Y. was not registered.

T. took a transfer of debentures from Y. for a nominal consideration, which had not been registered in the name of the contractor, but the transfer to Y. had been registered, and T. alleged that he gave value to Y. C. had a transfer for full value, and registered. These debentures had been authorized by a resolution passed at a meeting of the shareholders, at which an insufficient number were present. The contractor to whom the company issued them was present at the meeting and knew that fact. Upon the principles just stated, the court held that C. had a valid claim to be paid up his debentures, and that the company was estopped from setting up the irregularity of issuing them.

They also held that P. and T. must be

The principle by which a company may, in certain cases, be precluded from disputing its liability upon bonds, for the reason that the proceeds have been devoted to corporate uses, operates quite independently of the question whether the bonds in the given case are negotiable instruments or not.[1]

Nor can a corporation deny its corporate existence for the purpose of escaping liability on bonds issued by it as a corporation. As was emphatically said by the court in an Illinois case: "We are not saying that a corporation is estopped by its bonds and mortgage from raising the question as to whether, in making them, it was acting within its chartered powers. But we do say, that where a company has issued its bonds and mortgages under the circumstances above detailed, the courts of every civilized country must hold it estopped from denying its own corporate existence, for such a defence is repugnant to every sentiment of justice and good faith."[2]

In a case before the Supreme Court of the United States the ground was taken that, as certain bonds of a railroad company, to be exchanged for State bonds, were fraudulently issued by the officers of the company, the issue of the State bonds was unconstitutional, and the bondholders could therefore receive from the company only the amount they paid for them; but it was held that the bonds, though void as to the State, were valid as to the company which sold them; that, having been put upon the market as valid bonds, the companies were estopped from setting up their unconstitutionality.[3]

So it has been held in Alabama that, although railroad bonds were indorsed by the State, in contravention and fraud of the Internal Improvement Law of that State, and the indorsement was therefore void, the company was nevertheless liable on such of the bonds as it had secured by a trust deed on its property.[4]

treated as equitable transferees only, but without reason to suspect any irregularity in the issue, and that they could be allowed to recover such a sum as they might be able to show to have been *bona fide* advanced by them upon the debentures they held. *In re* Romford Canal Company (1883), L. R. 24 Ch. Div. 85. See also Bill *v.* Dareuth R. Co., 1 H. & N. 305.

In Tyrell *v.* Cairo & St. Louis R. Co. (1879), 7 Mo. Ap. 294, the defence of *ultra vires* was held not to be available against holders for value of negotiable bonds issued by the directors of the corporation where the stockholders failed to take any steps to repudiate the action of the directors, and, to the contrary, allowed the bonds to be sold, and availed themselves of the benefit thereof.

[1] Des Moines Gas Co. *v.* West (1878), 50 Iowa, 16. A like ruling as to certificates representing dividends on preferred stock which the holder was entitled to convert into bonds was made in Chaffee *v.* Rutland R. Co. (1882), 55 Vt. 110; 16 Am. & Eng. R. R. Cas. 408.

[2] Racine & Mississippi R. Co. *v.* Farmers' Loan & Trust Co. (1868), 49 Ill. 331.

[3] Railroad Companies *v.* Schütte (1883), 103 U. S. 118, 144.

[4] Kelly *v.* Trustees, etc. (1877), 58 Ala. 489; s. c. 21 Am. Ry. Rep. 138.

The same principle of estoppel will be enforced against any one who sells and gives currency to the bonds. Thus a contractor to whom bonds have been issued in part payment for work done by him, and who had thereafter purchased the corporate property at a receiver's sale, subject to all legal liens, and organized a new company, to which he transferred the property, was held estopped from alleging the invalidity of the bonds as a defence to a foreclosure suit instituted by the holders of the bonds.[1]

§ 11. **Bonds not void because Mortgage securing them is unauthorized.** — The bonds being the principal thing, and the mortgage securing them the accessary merely, the fact that a company has exceeded its authority in executing the mortgage will not have any effect on the validity of the bonds.[2]

§ 12. **Deferred Income Bonds, Power to issue.** — Whether a general authority to borrow money entitles a railroad company to issue deferred bonds without any provision for redemption is a question as to which there is a direct conflict between two courts. By the Federal Circuit Court for the Eastern District of Pennsylvania it has been held that such an authority is applicable only to such methods of borrowing as fall within the ordinary sense of the word, and cannot be made to cover any transaction which does not embrace the essential feature of a loan; viz., an obligation to return the property borrowed.[3]

The Supreme Court of Pennsylvania, on the other hand, has ruled, in regard to the same transaction, that the power to issue irredeemable bonds was one which might be exercised without any specific authority in the company's charter.[4]

[1] De Kay *v.* Voorhis (1882), 36 N. J. Eq. 37.

[2] Phila. & Sunbury R. Co. *v.* Lewis (1859), 33 Pa. St. 33.

[3] Taylor *v.* Phila. & Read. R. Co. (1881), 7 Fed. Rep. 386; s. c. 3 Am. & Eng. R. R. Cas. 163. The company in this case was undertaking to issue deferred bonds on the English plan, which placed the bondholders virtually in the position of stockholders, except as regards the right to vote. The issue was enjoined at the suit of a stockholder on the ground stated in the text, the court pointing out that in England such schemes are expressly authorized by act of Parliament. In the reporter's note to this case it is suggested that the "preferred stock" cases present some points of analogy. See Kent *v.* Quicksilver Mining Co. (1879), 78 N. Y. 159.

[4] Phila. & Read. R. Co.'s App. (Penn., 1882), 4 Am. & Eng. R. R. Cas. 118. The court considered that the view taken in the case just cited was too narrow, and that "while the borrowing of money is usually accompanied by a contract for the return of the principal in a stated time, it is not always nor necessarily so." The word "borrow," in its broader sense, it was thought, simply implies a contract for the use of money. If a sum of money, repayment of which is not to be demanded, is voluntarily advanced, the transaction is presumably entered into for some benefit to the lender. Judge Mercur dissented, on the ground that the contract, being one which entitled a stockholder who advanced $15 to receive $50, was usurious, and should, therefore, not be enforced by a court of equity.

§ 13. **Validity of Pledges of Bonds.** — Railroad bonds, being negotiable securities, may be pledged like other commercial paper.[1]

A company empowered to issue bonds to pay for the construction or operation of a road may pledge its bonds to raise money for the discharge of a debt already incurred for either of those purposes.[2]

An office being an essential adjunct of the business of a railroad company, a debt incurred for rent of an office is within this principle.[3]

A claim of a president of a company for his salary, being as legitimate as any other claim for services, may be secured by a pledge of the company's bonds.[4]

Although a note given by a company for money borrowed from a loan company may be void, as being in violation of the statute against unauthorized banking, the loan itself and the bonds pledged as a security therefor are valid and enforceable.[5]

A pledge of bonds to secure the private debts of a railroad company's treasurer is void, as against a subsequent judgment creditor, where the pledgee is aware of the purpose for which he received the securities, although the pledgor is the virtual owner of the road, and the debts were incurred in building it.[6]

Where the bonds of a corporation are issued on the understanding that they are to be sold for cash, but are in fact pledged to a creditor as collateral to secure corporate notes held by him, the objection that this disposition of them is unlawful is one that is open only to the corporation or the stockholders.[7]

§ 14. **When the Issue of Bonds will be enjoined.**[8] — It need scarcely be said that a stockholder can always procure an injunction to restrain an issue of bonds which is *ultra vires*.[9]

A stockholder in one company which is the equitable owner of stock in a second company which is a stockholder in a third company, is a stranger to the affairs of the third company,

1 Morris Canal & Banking Co. *v.* Fisher (1855), 9 N. J. Eq. 667.

2 Duncomb *v.* New York, Housatonic, & Northern R. Co. (1881), 84 N. Y. 190; s. c. 4 Am. & Eng. R. R. Cas. 293 (1881).

3 Ibid.

4 Ibid.

5 Ibid.

6 McKee *v.* Grand Rapids & Reed's Lake Street Ry. Co. (1879), 41 Mich. 274.

7 Beecher *v.* Marquette & Pac., etc. Rolling Mill Co. (1881), 45 Mich. 103.

8 For suits to annul bonds, see Chap. 11.

9 For recognitions of this doctrine see Taylor *v.* Phila. & Read. R. Co. (1881), 7 Fed. Rep. 386; s. c. 3 Am. & Eng. R. R. Cas. 163; Fidelity, etc. Co. *v.* West Penn., etc. R. Co. (1890), 138 Pa. St. 494; s. c. 21 Atl. Rep. 21. In the second case the right of the stockholders in such a case was referred to as being a matter of course.

and not entitled to maintain a suit to enjoin it from issuing bonds.[1]

An issue of bonds will also be restrained by injunction where the court is satisfied that they are about to be issued, not for the payment of money actually borrowed for the purposes authorized by the charter, but as a part of a fraudulent device to increase the stock.[2]

Neither preferred nor common stockholders can complain of the issue of income bonds in payment of the consideration of a contract shown to be valid, where the interest payable thereon is postponed to the dividends on the preferred stock, and the common stockholders are given the opportunity of exchanging their stock at par for the bonds to the total amount of the issue.[3]

§ 15. **Suits to annul Bonds.** — If corporate bonds are delivered for improper purposes by an officer having charge of them, a court of equity may declare them void, cancel them, and set aside a deed of trust given to secure their payment. A stockholder or stockholders combined may bring a suit for this purpose, where the corporation actually or virtually refuses to institute or prosecute such a suit. If there is a reasonable certainty that the corporation will refuse, the stockholders may bring such a suit without first requesting the corporation to bring it. Such suits may be brought against the director or directors who have been guilty of malversation; but it is absolutely necessary that the corporation be joined as a party, — usually defendant.[4]

And where no attempt has been made to enforce the payment of bonds thus wrongfully delivered for other than corporate purposes, a delay of eleven and a half years by stockholders before bringing such a suit has been held not to constitute a bar to the relief sought.[5]

The mere fact that stockholders to whom bonds are issued have paid no consideration for them will not entitle the holder of senior bonds not yet due to have the new issue cancelled, there being no averment that the corporation is in any way impairing or misusing the mortgaged property, or that the petitioner has any lien upon, claim to, or control of the earnings of the company, or that the

[1] Mayer *v.* Denver, T. & Ft. W. R. Co. *et al.* (1889), 38 Fed. Rep. 197.

[2] Belmont *v.* Erie Ry. Co. (1869), 52 Barb. 637. It was also intimated that while such bonds remained in the hands of persons affected with notice, that they did not represent a *bona fide* indebtedness, but were issued with a fraudulent design, the issue of stock in conversion of them might also be enjoined.

[3] Willoughby *v.* Chicago Junction Ry. & Union Stockyards Co. (1892), 50 N. J. Eq. 656; s. c. 25 Atl. Rep. 277.

[4] City of Chicago *v.* Cameron (1887), 120 Ill. 447; s. c. 11 N. E. Rep. 899.

[5] Ibid.

company has made default in the payment of the interest due on the bonds held by him or his co-bondholders.[1]

§ 16. **Certificates of Indebtedness.**[2] — In the adjustment of the affairs of embarrassed companies, a change in the form of their obligations is sometimes provided for by the issue of certificates of indebtedness representing the amount of the valid claims of a part or the whole of the creditors. Such an issue may be either for the mere purpose of facilitating a funding scheme, being made either as an exercise of corporate power implied from the authority to execute the original evidences of debt,[3] or by virtue of a special statute.[4]

It may be made under a statute operating virtually as a special insolvency act giving all the creditors who elect to take advantage of their provisions an equal participation in the security provided by them, without regard to whether they are unsecured.[5]

A railroad company which was limited by its charter to dividends of 10 per cent on a capital stock which could not be further increased, had accumulated from its earnings over and above dividends and expenses a surplus of 80 per cent on its capital stock. It was concluded to use this in constructing and equipping the road, purchase of property, etc., to increase its traffic. For this, in proportion to stock owned by each, the company issued to its stockholders certificates which it called "interest certificates," which certified that A. B., "being the holder of shares of the capital stock of the company, was entitled to $, payable ratably with the other like certificates, *at the pleasure* of the company out of its future earnings, with dividends thereon at the same rates and times as dividends should be paid upon the capital stock of the company." The certificates were declared transferable, with an appointment in blank of an attorney to transfer in the form common at the foot of certificates of stock. The United States revenue officers compelled a payment of an

[1] Bibb *v.* Montgomery Iron Works (1893), 101 Ala. 301; s. c. 13 So. Rep. 224.

[2] These instruments are issued by receivers or by a company. The rights under the former are discussed in connection with Receivers' Certificates.

[3] As in Skiddy *v.* Atlantic & Mississippi R. Co. (1879), 3 Hughes, 320, 323, 356.

[4] See, for example, the act discussed in Gibbes *v.* Greenville, etc. R. Co. (1879), 13 S. C. 228; 4 Am. & Eng. R. R. Cas. 459. The substance of this and the last case is given in Chap. II.

[5] An example of a statute of this class is the Massachusetts act of 1876, ch. 236, construed in Third Nat. Bank of Boston *v.* Eastern Railroad Co. (1877), 122 Mass. 240; Smith *v.* Same (1878), 124 Mass. 154; Pollock *v.* Same (1878), 124 Mass. 158; Elwell *v.* Same (1878), 124 Mass. 160; Merchants' Nat. Bank *v.* Same (1878), 124 Mass. 518; Hamor *et al.* Execrs., etc. *v.* Same (1882), 133 Mass. 315.

income tax on these certificates, under the internal revenue laws of the federal government. In an action by the company to recover the money thus paid from the collector, the U. S. Supreme Court construed these certificates. It was held that the issue of these certificates amounted to a "dividend in scrip" within the twenty-second section of the Internal Revenue Act of June 30, 1864, as subsequently amended, which enacts that "any railroad company which may have declared any *dividend in scrip* or money due or payable to its stockholders as part of the earnings, profits, income, or gains of such company, carried to the account of any fund or used for construction, shall be subject to and pay a tax of five per centum on the amount of such dividends or profits, whenever and wherever the same shall be payable;" and which authorized the company making such dividend to withhold the 5 per cent tax.[1]

1. *Refunding Bonds.*—An embarrassed railroad company, being unable to meet its bonded obligations, resorted to a plan of funding the old indebtedness in new bonds: for amounts under $1,000 it issued to the holders of the original bonds certificates of indebtedness; it also issued certificates of indebtedness in the fractional amounts for coupons past due, not requiring those who received them to waive the mortgage lien nor to accept the last-mentioned certificates as payment of the coupons for interest past due. It was held that these certificates were a substitution for the old obligations, and not a novation of the contract, and that

[1] Bailey *v.* Railroad Company (1874), 22 Wall. 604; s. c. 11 Am. Ry. Rep. 121. Referring to these "interest certificates," in the opinion rendered by Mr. Justice Clifford, it was said: "Such a paper, therefore, by whatever name it may be called, is, upon its face, evidence for each stockholder, to persons with whom he may have dealings, of the amount of the previous net earnings of the company; that such net earnings to the amount specified have been expended in constructing and equipping the railroad and in the purchase of real estate and other properties appertaining to the same, and that the holders of the certificates will be entitled to dividends whenever dividends are paid upon the capital stock." Again: "*Bona fide* holders of the certificates might demand that the certificates should be paid out of the future earnings of the company, or that they should be converted into stock whenever the company should be authorized to increase their capital to an amount sufficient for the purpose, and that they should have a *pro rata* share in the distribution of whatever assets may remain at the dissolution of the company." Again: "Corporation bonds are the representatives of money, because they are issued for sale in negotiable form; but certificates of stock are not securities for money, nor are they negotiable instruments in the strict commercial sense. Like dividends in scrip, they are simply muniments of and evidence of the holder's title to a described share or interest in the property and franchises of the corporation; and the dividend in scrip evidences the same extent of interest in such property and franchise as the dividend of stock, except that it is the right of the company to pay the same out of their future earnings, and that the dividend in scrip confers no right to vote."

they retained the lien on the properties which the original obligations were entitled to.[1]

2. *For Coupons unpaid.*— So the Supreme Court of South Carolina held that certificates of indebtedness issued by a company under authority of statute for coupons for interest due and unpaid on its bonds, which were secured by a lien under a certain statute which was extended by the statute authorizing the issue of these certificates to cover them, were but a substitution and not a payment, and therefore retained the original lien on the property.[2]

3. *To preferred Stockholders — "Scrip Dividend."*— A Vermont railroad company was authorized to issue preferred stock with the lien of a mortgage. Instead of paying dividends which were guaranteed upon such stock, it issued to the holders of the same, certificates of "scrip dividends," some of which on their face in express terms showing their convertibility into any mortgage bonds the company might issue, others not showing their convertibility; but in the case of the latter the officials of the company represented to purchasers of the same that they were convertible by action of the stockholders. One contention in the case involving these certificates was that the holders were creditors of the company and not stockholders. As between the holders and creditors for floating indebtedness, for instance, the court held the holders of the certificates not creditors, but stockholders, in effect, and that their right of payment would be subordinate to that of the owners of the floating indebtedness. As between the company and the holders of these certificates the latter were held to have the right to convert into bonds, and if the company had not so converted them or refused to do it, the holders had a right of action, — each holder in a suit in his own name for money against the company, on his certificates; and, under the circumstances of this case, the company was estopped from denying its power to issue such certificates.

As to the consideration for them the court said: —

"The right to dividends of 7 per cent existed under the charter when there should be funds applicable. As before shown, this is a continuing right. The company issued the certificates in settlement.

"The shareholder took them in settlement. The votes were in effect to pay the dividends in this form. The certificates

[1] Skiddy *v.* Atlantic, Miss. & Ohio R. Co. (1879), 3 Hughes, 320, 323, 356.

[2] Gibbs *v.* Greenville & Columbia R. Co. (1879), 13 S. C. 228; s. c. 4 Am. & Eng. R. R. Cas. 459.

were taken, and the right to a dividend in any other form surrendered.

"They were taken in settlement of a claim made by the shareholders, and recognized as valid by the company and authorized by the terms of the charter. There would be no question but that this would constitute a good consideration if the financial condition of the company had warranted a dividend." Again they said: "The company having obtained the surrender in the exercise of a power existing under the charter, and having always treated the certificates as resting upon the same consideration as though given in surrender of a dividend actually earned and warranted, cannot, under the facts disclosed, be heard to say that the certificate holders surrendered nothing."[1]

An individual agreed to purchase the whole stock of a railroad company from one who held it after the sale of the property of an old company under foreclosure of a mortgage and a reincorporation of it, and as consideration gave certificates for bonds of the company, to be delivered when issued and secured by mortgage, which were signed by himself as president and another as secretary of the company. There was a contest as to whether or not the lien of the certificates was superior to certain statutory liens of holders who had been engaged in the construction of the road.

It was urged that the certificates for bonds had all the force and effect of the bonds agreed to be issued, and that the court should regard the mortgage for their payment as having been executed at the execution and delivery of the certificates. The court said: "To make [these certificates] binding obligations upon the part of the corporation, they must have been authorized upon the part of the stockholders, or the directory of the company, or must have been within the scope of the business of the company and powers of the president and secretary, or by some clear and unmistakable act on the part of the stockholders and directory, ratified and confirmed." The court

[1] Chaffee *v.* Rutland R. Co. (1882), 55 Vt. 110; s. c. 16 Am. & Eng. R.R. Cas. 408.

In Calhoun *v.* St. Louis & E. R. Co. (1880), 14 Fed. Rep. 9, the court ordered a receiver of a railroad company to pay certificates of indebtedness issued by the company to its employees for work and labor done and for supplies and materials furnished in preference to mortgage liens. Those assigned were allowed for the amount given for them, and no interest was allowed on them. This order was made under the rule in Fosdick *v.* Schall, 99 U. S. 235. In United States *v.* Wilson (1882), 106 U. S. 520; s. c. 27 L. Coop. ed. 310, the Supreme Court of the United States held that certificates of indebtedness issued by a receiver of a railroad under order of the court were not taxable as "circulation" under the United States revenue laws, as, in their opinion, they were not calculated or intended to circulate as money.

held, under the facts, it had no power to convert these certificates into bonds and to create an equitable mortgage to secure their payments.[1]

§ 17. **State-aid Bonds.** — The nature of State-aid bonds and the rights created by them have been discussed in the following cases.

The remedies afforded by the State are given to and enforceable by the State alone; they cannot be set up by the purchaser of the road in a contest between them and the holders of indorsed bonds secured also by the corporation's mortgage, whatever might be their effect if the State were a party, and the holders of indorsed bonds secured also by the corporation's mortgage should seek to set up rights under the mortgage to embarrass the State in procuring the remedies.[2]

§ 18. **Convertible Land-grant Certificates.** — Instruments thus denominated have been issued under these circumstances. Congress granted to the State of Wisconsin certain lands for the purpose of aiding in the construction of railroads. The State granted them to a company, which mortgaged them to secure a bonded indebtedness. This mortgage was foreclosed and the lands transferred to a new company. An arrangement was made whereby these lands were devoted to the payment of such indebtedness of the old company; but the conditions of the grant not having been complied with, the title still remained in the United States. The new company therefore issued these instruments, certifying that after a certain time the bondholders were entitled to a deed to proportionate shares of the land. The bonds were surrendered for these.

It was held that the holders of these certificates had power to protect the lands from injury, and that the defendant was liable only for proceeds of timber received by it, or for timber used by it. The holders were the beneficiaries of a trust.[3]

§ 19. **Bonds convertible into Stock.** — Various questions arising on bonds convertible into stock are discussed in the cases and books referred to in the note below.[4] See further on this subject § 35, below.

1 Thompson *v.* Memphis, Selma, & B. R. Co. (1885), 24 Fed. Rep. 338.

2 Stevens *v.* Louisville & Nash. R. Co. (1880), 3 Fed. Rep. 673 (1880), Tenn. Bond Cases; Ralston *v.* Crittenden (1882), 13 Fed. Rep. 508 (1882); Tompkins *v.* Little Rock & Ft. S. Ry. Co. (1883), 15 Fed. Rep. 6; s. c. 18 Fed. Rep. 344 (1883); Williams *v.* Same (1883), ib.; s. c. 21 Fed. Rep. 370.

3 Beecher Ex. *v.* Chicago & N. W. R. Co. (1882), 14 Fed. Rep. 211.

4 Sturges *v.* Stetson (1858), 1 Biss. 246; Miller *v.* New York & Erie R. Co. (1859), 18 How Pr. 374; Ramsey *v.* Erie Ry. Co. (1869), 38 How. Pr. 193; Belmont *v.* Erie Ry. Co. (1869), 52 Barb. 637; Rorer on Railroads, 184; Woods' Ry. Law, 616.

§ 20. **Exchanges of Bonds and Rights thereunder.** — Rights arising out of exchanges of bonds have been discussed in the cases noted below.[1] See further on this subject § 36, below.

[1] Appeal of Allentown Nat. Bank, (1884), 18 Rep. 641; Barry *v.* Mo. K. & T. Ry. Co. (1888), 7 Ry. & Corp. L. J. 198; Mead *v.* New York, Housatonic, & Northern R. Co. (1870), 45 Conn. 199; s. c. 17 Am. Ry. Rep. 367; Union Pac. R. Co. *v.* Stewart, 95 U. S. 279; DeWitt *v.* Chicago, B. & Q. R. Co., 41 Fed. Rep. 484; Ames *v.* N. O., M. & T. R. Co., 2 Woods, 206; Turner *v.* Conant, 18 Abb. N. C. 160. For some of the statutes in some of the States affecting the matters covered by this chapter see the following: Ala., Code 1886, § 158, 114, Borrowing money. Ariz., Rev. Stat. 1887, § 310, ditto; § 319, Bonds must not exceed capital stock; § 320, Bonds previously issued validated. Ark., § 6175 (10), ditto; § 6268, Bonds may be sold at discount. Cal., Civ. Code, § 456, Borrowing money. Colo., G. L., ch. xix., § 4, Stat. 1891, § 476, Borrowing money; ch. xxx., § 618, Issue of bonds for labor done, etc. Conn., Gen. St. 1888, § 3570, Borrowing money and issuing bonds for; mode of disposal of bonds; issue of bonds, regulation of. Fla., Rev. St. § 2241 (10), Issuing bonds. Ga., Code 1882, § 1689 (*i*) (*nn*), Borrowing money, terms of. Idaho, Rev. St. 1887, § 2664, Borrowing money; issue and disposal of bonds. Ill., Rev. St. ch. 114, § 22, Issue of bonds for money, labor, etc.; § 20, Borrowing money. Ind., Rev. Sts. 1888, § 3911, Borrowing money; issuing bonds, terms of sale, etc.; ch. 19, § 3019, Disposal of bonds, interest, etc.; § 3020, Sale of at discount; ch. 37, § 3948, Issue of bonds by company incorporated by purchasers. Iowa, Code 1888, § 1965, Issue of bonds. Ky., Gen. Laws, § 771, Issue of bonds; § 568, Restrictions upon issue; must be for value. La., Rev. L. 1884, § 692, Borrowing money; issue of bonds. Me., Rev. St. 1883, ch. 51, § 56, Issue of bonds; terms of sale. Md., Pub. Gen. Laws 1888, art. 23, § 171, Borrowing money, restricted to amount of capital stock, etc.; § 189, By a new company formed by purchasers. Mass., Pub. St. 1882, ch. 112, § 62, Issue of bonds; § 65, Sold at less than par. Mich., 1882, § 3352, Borrowing money; § 3409, Issue of bonds, must be for money, labor, etc. Minn., St. 1891, § 2460, Borrowing money; issue of bonds; § 2523, For money, labor, etc.; § 2529, Terms of sale of bonds, in discretion of officers. Miss., Code 1892, § 3581, Issue of bonds; § 3600, Issue of bonds, for labor, etc. Mo., Rev. St. 1889, ch. 42, § 2499, Issue of bonds, for labor done, etc.; § 2543 (8), For construction and equipment. Mont., Civ. Code 1895, § 525, Issue of bonds for actual value; § 899, Borrowing money; issue of bonds; interest on bonds. Nebr., Comp. Laws 1895, §§ 1759, 1820, Issue of bonds; § 4043, By street-railway companies. Nev., Gen. St. 1885, § 849, Borrowing money; issue of bonds; limitation on rate of interest. N. H., Pub. St. 1891, ch. 157, § 26, Discount of bonds. N. J., Rev. St. 1709–1877, p. 519, § 6, Bonds sold below par; Supp. to Rev. 1877–1886, p. 153, § 35, Payment of bonds provided for by increase of capital stock; pp. 824, 825, § 12, Borrowing money; issue of bonds; limited to amount of capital stock; p. 839, § 59, By consolidated company; p. 842, § 71, Borrowing money, consolidated company; p. 847, § 94, Issue of bonds to complete leased roads; N. M., Comp. Laws 1884, § 2665 (4), Borrowing money; issue of bonds; terms, etc. N. Y., Rev. St. (8th ed.), p. 1752, § 10, Borrowing money; p. 1775, § 1, Borrowing money. N. C., Code 1883, § 1957 (10), Borrowing money; issue of bonds. N. Dak., Code 1895, § 2877, Issue of bonds for value, etc.; § 2906, Formalities; § 2947 (11), For construction and equipment; § 2962, Defence of usury prohibited. Ohio Rev. St. 1890, §§ 3286–3290, 3309(*a*), Issue of bonds; § 9814, By narrow-gauge companies; § 3313, Bonds purchased by directors void. Okl., St. 1893, § 1011, Issue of bonds; § 1023, Plea of usury prohibited. Pa., Dig. Suppl. 1887, p. 2378, § 5, Issue of bonds for value, etc.; capital stock must be fully paid up; Dig. 1883, p. 1415, § 6, Restricted to so much per mile; Dig. Supp. 1887, p. 1416, § 8, Limited to double the stock paid up;

§ 21. "**Lloyd's Bonds.**" — Bonds issued purporting to be for work done or materials supplied for the purposes of the undertaking are called in England "Lloyd's Bonds;" and these have been sometimes issued by companies for the purpose of defeating the limitations by Parliament on the power of companies to borrow money. They may be sued upon, judgment recovered, and execution issued. *In re* Cork & Youghal R. Co.[1] the holders of such bonds were held to have a valid claim against the assets of the company to the extent the company had been benefited by the money raised on the bonds.

p. 1422, § 43, Same as to narrow-gauge companies; p. 140, § 77, By consolidated companies. S. C., Gen. St. 1882, Mortgages must include bonds previously issued. So. Dak., Comp. L. 1887, § 2981, Borrowing money; issue of bonds. Tenn., Code 1884, § 1251, Borrowing money; issue of bonds. Tex., Civ. Stats. 1888, § 4219, Borrowing money; § 4222, Converting bonds into stock; § 4154, Issue of bonds for money, labor, etc. Utah, Comp. Laws, 1888, § 2368, Issue of bonds; valid though sold below par. Vt., Rev. Laws 1880, § 335, Bonds sold below par valid; St. 1894, § 3797, Issue of bonds, interest not to exceed seven per cent; § 3799, Sold below par. Va., Code 1887, Borrowing money, limitations upon power. W. Va., Code 1891, ch. 54, § 50 (11), Issue of bonds for construction and operation; § 52, Bonds sold below par; for money, labor, etc. Wis., Ann. Stats. 1889, § 1828 (10), Issue of bonds for construction and equipment. Wyo., Rev. St. 1887, § 549, Issue of bonds; sale below par; plea of usury prohibited.

[1] L. R. 4 Ch. 748. Blackmore *v.* Yates, 36 L. J. Exch. 121, is a case involving an assignment of rolling-stock to satisfy a Lloyd's bond. As to the rights of the holders of a Lloyd's bond against the directors of a company, see Rashdall *v.* Ford, 35 L. J. Ch. 769; Beattie *v.* Lord Ebury, L. R. 7 Ch. 777; 41 L. J. Ch. 804; Weeks *v.* Propert, 42 L. J. C. P. 129. For a review of the cases involving "Lloyd's Bonds" up to 1870, see *In re* Bagnalstown & Wexford R. Co., I. R. 4 Eq. 505. For a case showing the circumstances under which such bonds, in the hands of a purchaser for value without notice, may be good, see *In re* South Essex Estuary Co., *Ex parte* Chorley, L. R. 11 Eq. 157.

CHAPTER II.

RIGHTS OF BONDHOLDERS.

Article I. — Rights of Bondholders generally, not involving the Negotiable Character of such Bonds.

§ 22. **Bonds and Mortgage must be construed together.** — The bonds and mortgage are one obligation, and should be read and construed together.[1]

The mortgage may qualify the absolute promise of the bond. There is, however, an apparent conflict of opinion as to the effect of a reference in the bonds to the mortgage. It has been held that a mere recital in a bond, that it is secured by a mortgage, does not import the terms of that mortgage into the bonds either to the advantage or disadvantage of a bondholder. A default in the interest on such a bond does not entitle the holder to sue for the principal of the bonds, independently of foreclosure proceedings, although the mortgage provides that, in case of default, one-third of the bondholders in amount may require the trustee to sell the property, and that the bonds shall forthwith become due and payable. To hold that a single bondholder could precipitate the maturity of the bond by a suit would be quite incompatible with the requirement that a sale can be procured only at the instance of a certain proportion of the whole class to which he belongs.[2]

The Supreme Court of Minnesota has also held that the holder

[1] Marlor *v.* Texas & Pacific R. Co. (1884), 19 Fed. Rep. 867; Marlor *v.* Texas & Pacific Ry. Co. (1884), 21 Fed. Rep. 383; s. c. 22 Blatch. 464, affirmed in Texas & Pacific Ry. Co. *v.* Marlor (1887), 123 U. S. 687. See also Van Weel *v.* Winston (1885), 115 U. S. 228, cited below.

[2] American Nat. Bank *v.* American Wood Paper Co. (R. I., 1895), 32 Atl. Rep. 305.

of a bond will not be deprived of his rights as an innocent purchaser of an instrument *prima facie* negotiable, because a mortgage to which it refers in general terms contains provisions which limit his personal right of action on the security.[1]

The Supreme Court of New York, however, has decided that a purchaser of bonds which refer to a mortgage is bound by any statement contained therein.[2]

The report of the New York case does not show the character of the reference to the mortgage, whether it was merely general or particular. If it was particular, it is not inconsistent with the two cases above cited, and harmonizes with a decision of the New York Court of Appeals to the effect that, where there is an express reference on the face of the bond to the terms and conditions of the mortgage, and the mortgage authorizes the trustees to postpone the payment of interest becoming due, coupon-holders are bound by their action, and are not entitled to sue upon their coupons in a court of law.[3]

That the provisions of the bonds are controlling as to when there has been a default, see Chap. XIX.

[1] Guilford *v.* Minneapolis S. Ste. M. & A. Ry. Co. (1892), 48 Minn. 560; s. c. 51 N. W. Rep. 658.

In this case the mortgage provided that the bondholders were not to take any proceedings at law or in equity to enforce their debt, until the trustee had been requested to take action and neglected to do so. It was held that as the bonds did not contain this restriction, they were not rendered non-negotiable because of the general reference in them to the mortgage. The court said: "Bonds of this character generally refer to the mortgage or trust deed by which they are secured; and being placed in the market as negotiable securities, to be sold to *bona fide* purchasers, the fair inference from the general recital in the bonds, that it is one of a series secured by a mortgage deed to a certain trustee, upon the property of the railway company, whose absolute obligation it purports to be, is that such recital is introduced into the bond to indicate the nature of the security and add to the credit of the bond, and does not alone import into the bond special provisions not affecting the nature or enforcement of the security, and at variance with the tenor of the bond itself. The policy of the law is to hold such instruments negotiable, unless there is enough on the face of the bond to suggest inquiry in respect to the existence of facts destroying their negotiability."

[2] Caylus *v.* New York, etc. R. Co., 10 Hun, 295 (1877). This New York case was distinguished by the Minnesota court in Guilford *v.* Minneapolis S. Ste. M. & A. Ry. Co., *supra*, on the ground that the bondholder was not a *bona fide* purchaser.

[3] McClelland *v.* Norfolk Southern R. Co. (1888), 110 N. Y. 469, 473; s. c. 18 N. E. Rep. 237. See 19 Am. L. Reg. (N. S.) 725, report of an English case; National Bolivian Navigation Co. *v.* Wilson (1880), L. Rep. 5 App. Cas. 176, on rights of bondholders; Smythe *v.* Chicago & S. R. Co. *et al.* (1879), 8 Rep. 709; s. c. 22 Fed. Cas. 710, Case No. 13,135. For a case discussing a suit by bondholders to protect the property of the company bound as a security for the bonds, see Newby *v.* Oregon Cent. Ry. Co. (1870), 1 Sawy. 63; s. c. 18 Fed. Cas. 42, Case No. 10,145. For a case discussing remedies of bondholders where there have been land grants to railroads, see Chamberlain *v.* St. Paul & Sioux City R. Co. *et al.* (1873), 1 Cent. L. J. 53; s. c. 5 Fed. Cas. 417, Case No. 2578.

§ 23. **Bonds inoperative as Obligations until issued to Purchasers.** — Bonds and a mortgage securing them, while in the hands of a trustee, and before they are sold, pledged, or used in any way, are subject to the control of the maker, who has the right to have the bonds cancelled and the mortgage discharged.[1] Hence they cannot be levied upon before they are delivered.[2]

In the case cited below, a manufacturing corporation had executed a mortgage on its plant and delivered it to a trust company as trustee to secure bonds which were placed in the hands of the trustee for the purpose of being sold, and the proceeds to be turned over to the mortgagor. A portion of these bonds remained in the possession of the trustee unsold, and the trustee had made no advances upon them. A creditor of the mortgagor sought to reach these unsold bonds as property of the mortgagor, to be applied to the settlement of its debts. The court held that these unissued bonds of the mortgagor did not constitute a part of its property or assets.[3]

The court further held that the rights of the mortgagor to any surplus which might remain in the hands of the trustee, or to a release in case the bonds were paid in full by the mortgagor, and to require a return of the bonds in the hands of the trustee, were too contingent and conjectural to be reached as property and applied in payment of its debts.[4]

But the lien created by a pledge of its bonds by a corporation itself may be waived by the pledgee, and he may levy upon the bonds an execution obtained against the corporation for the debt.[5]

The lien of all the bonds of a series issued by a railroad company is not affected by the time at which it was issued. All the bonds of the series outstanding in the hands of *bona fide* holders for value are equal in priority, the lien of each bond dating from the record of the mortgage securing it, and not from the time it was issued.[6]

[1] Peninsular Iron Co. *v.* Eells (C. C. A., 1895), 68 Fed. Rep. 24.

[2] Means *v.* Cincinnati & Chicago R. Co. (1859), 2 Disney (Ohio), 465; Sickles *v.* Richardson, 23 Hun, 559.

[3] Eastern Electric Cable Co. *v.* Great Western Manufacturing Co. *et al.* (1895), 164 Mass. 274; s. c. 41 N. E. Rep. 295, citing, in support of the ruling, Richardson *v.* Green (1890), 133 U. S. 30, 47; Coddington *v.* Gilbert (1858), 17 N. Y. 489; Barnes *v.* Mobile & Northwestern Railroad (1877), 12 Hun, 126; Sickles *v.* Richardson (1881), 23 Hun, 559.

[4] Eastern Electric Cable Co. *v.* Great Western Manufacturing Co. (1895), *supra*, citing, in support of this ruling, Pettibone *v.* Toledo, Cin. & St. Louis Railroad, 148 Mass. 411 (1889); s. c. 19 N. E. Rep. 337.

[5] Sickles *v.* Richardson (1881), 23 Hun, 559.

[6] Pittsburgh, C. C. & St. L. Ry. Co. *v.* Lynde *et al.* (Ohio, 1896), 44 N. E. Rep. 596.

The mortgage itself is not operative until the bonds are delivered to the purchasers.[1]

§ 24. **No Vendor's Lien in Favor of Seller of Bonds.** — Corporate bonds being personal property, there is no lien for purchase-money where the title to such bonds has passed from a seller, and they have been delivered to a buyer.[2]

§ 25. **The Relation of Bondholders to the Road is sometimes substantially that of Proprietors.** — Arrangements have been made in one case which, so far as the management of the property is concerned, place the bondholders in the position of proprietors, and leave the stockholders a merely nominal interest in the business. Such is the result where the value of the road is much less than the bonded debt, and the stock is issued not directly to the stockholders, but to trustees elected by the bondholders, to be voted on by the latter. A court of equity will not, under these circumstances, entertain a petition by the stockholders to set aside a lease made by the company as thus controlled by the bondholders.[3]

§ 26. **The Relation of Bondholders to each other generally.** — A bondholder is in equity a *quasi* owner in common with the other bondholders of whatever rights the mortgage gives. He is not a partner with them, nor *strictly* a tenant in common, but the relation with which he introduces himself by his purchase imposes upon him some duties. Having a common interest with others in the security of the mortgage, he is under the duty of so acting as not to destroy its value. He has a right to make use of the mortgage to enforce the payment of his bonds, but not to obtain an advantage over the other bondholders. Equity will not permit him to reap the profits of a sale made in pursuance of a scheme for obtaining possession of the property in conjunction with strangers to the security, and so conducted as to result in the transfer of that property at a totally inadequate price.[4]

[1] Wade *v.* Donan Brewing Co. (1894), 10 Wash. 284; s. c. 38 Pac. Rep. 1009.

[2] Farmers' Loan & Trust Co. *v.* Pine Bluff Ry. Co. (Ark., 1893), 21 S. W. Rep. 652.

[3] McHenry *v.* New York, P. & O. R. Co. (1884), 22 Fed. Rep. 130. In England it would seem that bondholders are, in a sense, considered as part proprietors of the existing capital of the company, and dealt with by Parliament and the courts accordingly. Canada So. R. Co. *v.* Gebhard (1883), 109 U. S. 527, per Waite, C. J., referring to Canadian Ry. Co.'s scheme, L. R. 3 Ch. 294. The statutes of Vermont make a bondholder who has not entered into a reorganization scheme a tenant in common with the new corporation. Brooks *v.* Vermont Cent. R. Co. (1884), 22 Fed. Rep. 211.

[4] Jackson *v.* Ludeling (1864), 21 Wall. 616. As to the rule that any litigation instituted by a bondholder to enforce his debt through the mortgage must be for the benefit of his co-bondholders as well as himself, see hereafter. See also § 27,

§ 27. **Majority and Minority Rights.** — No majority of the bondholders, however large, can, by direct means, compel a minority, however small, to enter into an agreement which involves the surrender of a portion of their rights.[1]

But it is now the accepted doctrine that, in view of the peculiar character of corporate bonds, each bondholder is deemed to have entered by implication into certain contract relations with his co-bondholders, which, although not identical with, are analogous to, the relations existing between stockholders; and that, as regards the determination of the question, what is the most desirable way of safeguarding and promoting the interests of the whole class, the will of the majority must often be allowed to prevail, even though the indirect result of the course adopted may be seriously to impair the value of the rights to which individual bondholders are technically entitled.

Thus the appointment of a receiver in deference to mere technical rights of a very small minority of bondholders has been refused where it appeared that such action would imperil, if not destroy, the interests of others whose rights were entitled to equal consideration.[2]

So a foreclosure sale will not be delayed, at the instance of a few bondholders, for the purpose of ascertaining and determining the conflicting rights of lienors, where the various trustees and much the larger part of the creditors are of opinion that the interest of all concerned will be subserved by an immediate sale.[3]

But the results of the application of this principle referred to are most frequently illustrated in those cases where reorganization schemes are carried through in opposition to the wishes of a minority of the bondholders. It is sufficiently obvious that a minority can never have the power to prevent the consummation of such schemes through a foreclosure and a purchase by the majority; for if there is no limitation in the mortgage on the right to foreclose, even a single bondholder may enforce his lien in that manner, and no mortgage has ever been drawn with any specific

below. Gates *v.* Boston & New York Air Line R. Co. (1885), 53 Conn. 333; s. c. 24 Am. & Eng. R. R. Cas. 143; 5 Atl. Rep. 695.

[1] Canada So. R. Co. *v.* Gebhard (1883), 109 U. S. 527; see also Waldoborough *v.* Knox & L. R. Co., 84 Me. 469; s. c. 24 Atl. Rep. 942.

[2] Tysen *v.* Wabash Ry. Co. (1878), 8 Biss. 247. There was another reason for the court's action in this case, viz., that a large majority of the bondholders and stockholders favored a funding plan which was being negotiated.

Similar considerations have influenced a court to refuse to appoint a receiver for a canal company on the application of a single bondholder. Stewart *v.* Chesapeake & Ohio Canal Co. (1881), 5 Fed. Rep. 149, 153.

[3] First Nat. Bank of Cleveland *v.* Shedd (1887), 121 U. S. 74.

restriction on this right except in favor of the majority. The property, being thus exposed for sale to the highest bidder, must inevitably pass to any person or persons who satisfy that description; and the alternative finally set before the minority is either to see the property acquired by others, or buy it in themselves. Whichever of these alternatives is chosen, the rights of the minority will evidently have been in some measure sacrificed.[1]

Agreeably to the above principle, it has been laid down by the highest authority that to allow a small minority of bondholders, in the absence of any pretence even of fraud or unfairness, to defeat the wishes of a majority of those associated with them in the benefits of their common security, would be to ignore entirely the relation which bondholders bear to each other.[2]

It is scarcely necessary to point out that no transaction in which the exercise of this power of the majority to coerce the minority indirectly is tainted with fraud will be allowed to stand. For instance, a trustee who is also a representative of a committee or syndicate of bondholders cannot, in actual fraud of the rights of the minority bondholders, enter into a scheme with such syndicate to sacrifice the property, so that the syndicate may acquire the same in a manner to defraud the minority.[3]

The majority having the power virtually to override the wishes of the minority to this extent, it follows that no legislation which merely facilitates and regulates the exercise of this power can be objected to on the ground of its unconstitutionality. Thus it is competent for the legislature to pass an act requiring bondholders to take some positive action when an arrangement for the disposition of the property is proposed by the majority, and providing that all should be bound by such arrangement who did not, in some direct way, within a reasonable time after notice, signify their refusal to concur.[4] So also the legislature may authorize the bondholders, by a vote of the majority, with equal oppor-

[1] See further, as to the validity of such proceedings as against the minority, Chap. XXXVII. (Reorganization).

[2] Shaw *v.* Railroad Company (1879), 100 U. S. 605.

[3] Sahlgaard *v.* Kennedy (1880), 2 Fed. Rep. 295. Nelson, D. J., said: "While there is no doubt that creditors may combine to purchase the property of their debtor, and such action is proper and will be sustained, yet if a trustee, holding the property for the benefit of all the creditors, combine with a part to aid them in purchasing it to the exclusion of the other creditors, and the trustee also has in his possession, as agent, the evidences of debt belonging to the creditors with whom he has combined, and the property, by the act of the trustee, passes into the possession of those creditors at a price much less than its value, it can hardly be claimed that a purchase thus consummated is not inequitable."

[4] Gilfillan *v.* Union Canal Co. (1883), 109 U. S. 401.

tunity to all, to reorganize as a new corporation with the rights of the old.[1]

The extent of the power of a legislature to compel the minority to submit to the majority is of course unlimited in theory, where, as in Canada, there is no constitutional restriction against passing laws which impair the obligation of contracts.[2]

§ 28. **Powers of Majority under Express Clauses in the Mortgage.** — Each bondholder holds his interest subject to the controlling power given to the majority of the bondholders by an express provision in the mortgage, as where the trustee is empowered to purchase at the foreclosure sale, upon receiving a written request from the majority, and to organize a new company for the benefit of the bondholders, upon such terms, conditions, and limitations as the majority may direct.[3]

A trustee is authorized to discontinue a suit for the collection of the mortgage debt, if the majority of the bondholders so desire, where the mortgage empowers him to commence such litigation at the instance of a majority of such bondholders.[4]

[1] Gates *v.* Boston & New York Air Line R. Co. (1885), 53 Conn. 333; s. c. 5 Atl. Rep. 695; 24 Am. & Eng. R. R. Cas. 143. The court based its decision on two grounds: (1) The *quasi* public character of a railroad corporation; (2) the more special consideration that, in view of the nature of this class of securities, a minority cannot obstruct the action of the majority beyond a certain point.

Judge Stoddard said: "Upon principle it would seem plain that railroad property once devoted and essential to public use must remain pledged to that use, so as to carry to full completion the purpose of its creation; and that this public right, existing by reason of the public exigency, demanded by the occasion, and created by the exercise by a private person of the powers of a State, is superior to the property rights of corporations, stockholders, and bondholders." [As illustrating this general principle, see High on Mandamus, §§ 315, 316, 317; State *v.* Hartford & N. H. R. Co. (1861), 29 Conn. 538; R. Commissioners *v.* Portland & Oxford R. Co. (1874), 63 Me. 269, 278; Attorney-General *v.* West Wisconsin R. Co. (1879), 36 Wis. 466; People *v.* Albany & Vermont R. Co. (1862), 24 N. Y. 261; People *ex rel.* *v.* Long Island R. Co. (1883), 31 Hun, 127; Attorney-General *v.* Southern Minnesota R. Co. (1871), 18 Minn. 40; *In re* New Brunswick & Canada Ry. Co., 1 Pugsley & Barb. (N. B.) 667; York & North Midland Ry. Co. *v.* The Queen, 1 El. & Bl. 858.]

In a subsequent part of the opinion in Gates *v.* Boston & New York Air Line R. Co., *supra*, the learned judge drew attention to the provision in the mortgage that "should any of the coupons remain unpaid for six months after presentation and default, the principal sum secured hereby shall, at the option of the holder, become due and payable," and said: "In relation to the other bondholders it is manifest that each bondholder enters into contract relation with each and all of his co-bondholders. His right to appropriate the security in satisfaction of his bond is modified by the same existent right in every other holder. His absolute right of control is limited not only by the express provisions of the mortgage, but also, in a great measure, by the nature and character of the security."

[2] Canada So. R. Co. *v.* Gebhard (1883), 109 U. S. 533. See further as to this case, Chap. XXXVII. (Reorganization).

[3] Sage *v.* Central Railroad Co. (1878), 99 U. S. 334.

[4] Elwell *v.* Fosdick (1889), 134 U. S. 500.

Similarly a clause in a trust deed empowering a three-fourths majority to "assent to any modifications" of the provisions of the deed justifies a court of equity in sanctioning a scheme accepted by the requisite majority, whereby persons who agree to advance money to the corporation, are to receive a rent charge, which is to stand in priority to the debentures.[1]

In a recent case before the U. S. Circuit Court of Appeals of the Second Circuit, a brewery company had issued bonds to the amount of $1,000,000, and secured them by a trust deed. The bonds, by an indorsement upon them, could be declared due after a default of three calendar months; but this right of the bondholders was subject to a provision of the trust deed which placed it in the power of three-fourths in interest of the bondholders to agree with the company for any modification or alteration of the contract, including the release of the property charged, and any postponement of the time for the payment of the moneys secured, etc., which was to bind the minority. After the default in payment of interest, Y., the principal stockholder of the company, induced B., an outsider, to pay up such an amount of the bonds as would constitute, with those owned by Y. and his relatives, such a majority as provided in the trust deed. Y. having an option to purchase from B. the bonds, he might purchase and hold. Y. and B., with the others in sympathy with their purpose, entered into an agreement with the company, and evidenced their agreement by a consent that the company and trustees should sign an agreement to postpone the payment of all interest coupons past due and to become due until the year of the maturity of the bonds. A., holding some of the bonds, brought an action upon them, and the trial court directed a verdict for the defendant, taking from the jury the consideration of the question of the *bona fides* of this consent. The Circuit Court of Appeals held that the evidence upon the trial presented such a question for the jury, and it was error to withdraw it from their consideration. Wallace, Circuit Judge, said: "We cannot doubt that a consent to postpone the payment of the demands of the minority bondholders, made collusively by majority bondholders for the purpose of defeating the remedy of the minority, and not in the exercise of an honest discretion in the general interest, is not a consent within the meaning of the eleventh condition; or that a vote at a meeting of bondholders, sanctioning a modification of the rights of the bondholders, passed by a corrupt majority for the purpose of effectuating such

[1] *In re* Dominion of Canada, etc. Co. (1886), 55 L. T. N. S. 347.

a collusive consent, is not within the power contemplated by the provision in the trust deed."[1]

A mere general clause to the effect that a resolution by the majority of the holders of debenture stock will "bind all the holders as effectually as if all such holders were competent to consent, and had consented thereto in writing for a valuable consideration," will not warrant a resolution, sanctioning the application of certain funds vested in trustees, and set apart for the payment to debenture-holders of the interest on their debentures. The words of such a clause, however wide, cannot be supposed to

[1] Hackettstown National Bank *v.* D, G. Yuengling Brewing Co. (1896), 74 Fed. Rep. 110. It was also said in this case: "Powers in trust deeds, conferred on a majority of bondholders, to bind the minority, have been the subject of consideration in several cases in the English courts, and were given full effect. In these cases the power was contained in a provision similar to that in the present trust deed, by which the bondholders at a meeting, by extraordinary resolution, were authorized to sanction any modification or compromise of the rights of the bondholders against the company or its property. It was assumed by the court in all of these cases that the power was only called into existence when required by the exigencies of the situation, and when exercised must be exercised in good faith. Mercantile Investment & General Trust Co. *v.* International Co. of Mexico (1893), 1 Ch. 484, note; Mercantile Investment & General Trust Co. *v.* River Plate Co. (1894), 1 Ch. 596; Follit *v.* Eddystone Granite Quarries (1892), 3 Ch. 75; Sneath *v.* Gold Co. (1893), 1 Ch. 477. In the above cases the holdings were as follows:

A power given to the majority to "sanction any modification or compromise of the rights of debenture-holders against the company or against its property" does not justify the passage of a resolution to the effect that the rights of the debenture-holders be compromised by the acceptance, in lieu of such debentures, of preference shares in another company. It was remarked by Lindley, L. J., that ambiguities of language ought not to be taken advantage of to stretch powers given to majorities. "The power to compromise the rights of the debenture-holders presupposes some dispute about them, and does not include a power to exchange their debentures in another company, where there is no dispute or difficulty." Mercantile Investment & General Trust Co. *v.* International Co. of Mexico (1893), 1 Ch. (C. A.) 484 n.; s. c. 7 Times R. 616; 40 Am. & Eng. Corp. Cas. 337.

A resolution of debenture-holders sanctioning a loan to the debtor corporation, and providing that it shall take priority over the debentures as a charge on the corporate property, is a "modification" of the rights of such debenture-holders within a condition in the covering deed authorizing a certain majority of such holders to "sanction any modification or compromise of the rights" of the whole class of lienors, and if such a resolution is duly passed by the requisite majority it is binding on the dissentient minority. Follit *v.* Eddystone Granite Quarries (1892), L. R. 3 Ch. 75; s. c. 41 Am. & Eng. Corp. Cas. 49.

An appropriate occasion for the operation of such an enabling clause arises where the whole of the property subject to the charge will be forfeited unless a sum of money is paid by the company at a certain date, and an arrangement is proposed by which a new company is to be formed to supply the money and carry on the business. An agreement by the debenture-holders to accept shares in that company in lieu of their debentures is a "compromise" of their rights, and may be entered into by the majority so as to bind a dissenting minority. Sneath *v.* Valley Gold (1893), L. R. 1 Ch. 477, distinguishing Mercantile Investment & General Trust Co. *v.* International Co. of Mexico, *supra.*

contemplate the passage of a resolution which would be inconsistent with the rights given to the debenture-holders under the body of the trust deed.[1]

§ 29. **Subscriptions for Bonds, Rights under.** — A secret agreement that subscribers for railroad bonds should be required to take and pay for only part of the bonds subscribed for, is fraudulent as to other subscribers and void; and the subscription is a valid one for the amount subscribed.[2]

Where the property mortgaged to secure bonds, for the subscription price of which a judgment has been rendered against a subscriber, has already been sold, he is entitled in equity to have credited and allowed on such judgment the proportionate share of the bonds in the avails of the property.[3]

§ 30. **Bondholders' Rights under Circulars issued by the Company.** — Bondholders, although relying upon a statement in a prospectus of promoters which might be construed to be a promise that the moneys derived from the sale of the bonds would be used for certain specified objects, and not otherwise, cannot, upon the theory of a trust, reclaim the money, when the promoters have paid it out to creditors of the company, disregarding this promise, and follow it into the hands of persons who received it lawfully from the promoters, although with notice of the promise.[4]

[1] Hay *v.* Swedish & Norwegian Ry. Co., 5 Times L. R. 460. The rule as to the construction of such powers, they being in derogation of the rights of the minority, is that they must be strictly construed.

[2] Cleveland Iron Co. *v.* Ennor (Ill.), 2 West Rep. 831.

[3] Ibid.

[4] Banque Franco-Egyptienne *v.* Brown (1888), 34 Fed. Rep. 162 [bill for rescission of the contract of purchase of bonds on the ground of fraud in false representations in prospectus for the sale of these bonds].

Wallace, J., in this case stated some rules which are pertinent to the subject of this section, to wit: Misrepresentation by prospectus, except as between promoters and shareholders, is to be tried by the ordinary criterion of misrepresentation. But a reasonable construction of the language of a prospectus may require that a future tense should be given to words in the past or present tense. A right of rescission because of misrepresentations in a prospectus must rest upon misrepresentations concerning material facts and not of mere matters of opinion, and must relate to existing facts and not to matters of future conduct or expectation. It cannot be founded upon the breach of pure promissory statements. Unless promissory statements are such as imply that a certain condition of things or state of facts exists at the time to form the basis of the promised future state of things, they do not give birth to a right of rescission. Fraud cannot be predicated of promises not performed for the purpose of avoiding a contract. If a prospectus contains false representations, those who authorize it to be issued cannot repudiate them as made without their authority, while retaining the fruits of the prospectus. A statement in a prospectus respecting the way in which the moneys to be derived from the sale of bonds are to be applied is to be construed as a representation of intention, or the expression of the expectation and purpose of the promoters, if the language falls short of a distinct and unequivocal promise.

A *bona fide* purchaser of bonds at less than par, where a company has issued a circular which neither placed any limits upon the price nor mentioned any restriction of its charter as to the price for which its bonds might be sold, and asked proposals for purchase of bonds, is not bound by restrictions in the charter, and is protected against a defence that such a sale of bonds was illegal.[1]

Where the president of a company issues circulars signed by him in his official capacity, inviting subscriptions to bonds, the representations therein will usually be considered as the representations of the company, and he cannot be made personally liable to a purchaser of the bonds for misstatements as to the length of the proposed line. The position of such a purchaser in a suit for relief on the ground of misrepresentations is still weaker where a mortgage securing the bonds is subsequently executed, reserving to the company the right to build a shorter line if the interests of the company should require it; for the representations in the circular are superseded by the provisions of the mortgage, and the purchaser is bound to look to the mortgage for the description of the mortgaged property.[2]

§ 31. **Control of the Proceeds of Bonds.** — Money in the hands of the directors of a company realized from a sale of its bonds, where the purposes of its use have been set forth in the mortgage, constitutes a trust fund, to be used in good faith by the company for those purposes.[3]

[1] Ellsworth *v.* St. Louis, Alton, & Terre Haute R. Co. (1885), 98 N. Y. 553, affirming s. c. 33 Hun, 7. The court said: "A (railroad) corporation (having) a general power to make contracts and to borrow money, . . . persons dealing in securities issued by it may, in the absence of notice to the contrary, assume that restrictions upon this power have not been violated."

[2] Van Weel *v.* Winston (1885), 115 U. S. 228.

[3] A purchaser of some of these bonds in open market, with notice of the facts, well known to the bankers from whom he purchased them, afterwards sought, in a court of equity of the State of New York, to have the funds raised upon these bonds, which he claimed were diverted from the purpose stated in the covenant embraced in the mortgage, reatored by the defendants and applied to the betterment of the security. The Court of Appeals of New York, on the ground of his peculiar relation to the case and his knowledge, etc., held that he was not entitled to relief. Belden *v.* Burke (1895), 147 N. Y. 542; s. c. 42 N. E. Rep. 261.

The court, however, held that subsequent holders of these bonds in good faith and without notice would not be precluded from relief on the ground that the first takers of the bonds from the railroad company took with notice of the actual transaction.

See Columbus, Hocking Valley, & Toledo Ry. Co. *v.* Burke (1887), Court of Common Pleas, Ohio, 3 Ry. & Corp. L. J. 26, where the use of such a trust fund by the directors of the company in purchasing from a majority of themselves and others the entire capital stock of a mining corporation was held *prima facie* a violation of the rights of the owners and hold-

But there is no privity or trust relation between the president of a company and the bondholders as to the use of the money borrowed. The right to redress for any improper use of the money by the president is not in the bondholders, but in the company or its stockholders,[1] who may maintain suit against directors illegally diverting such funds for an accounting as to the funds received by them. If, for instance, a majority of the directors have made an illegal purchase of property from themselves with such a trust fund, the company would not be estopped from an action by the fact that a minority of its directors had no interest as sellers, nor by the fact that at the time of such a purchase and misuser of the funds the directors owned all of its capital stock, and as stockholders unanimously ratified what they as directors had done.[2]

The agents for the negotiation of bonds of a railroad company sold its bonds and became accountable for the price, but afterwards bought them back in their own interest, and led the company to suppose that they had not been negotiated. Afterwards they made a loan to the company upon these bonds as collateral security, at the same time entering into an agreement that the trustees (who had the equitable title to the proceeds) would treat the loaned money as a trust fund, and disburse it for certain specified objects. The survivor of this firm, which was the agent of the company, brought suit to enforce the agreement, alleging an appropriation by the trustees of this firm to foreign purposes. It appeared that the company was in ignorance that there had ever been a negotiation of these bonds, and that this firm had then in its hands moneys unaccounted for. It was held that a court of equity would not assist the complainant, as he did not come into court with clean hands, and that the trustees could invoke the principles of equitable set-off to defeat the action.[3]

As to the right of the bondholders to reclaim the unspent proceeds of the bonds, see the preceding and the following sections.

§ 32. **When Bondholders are entitled to demand Repayment of the Unspent Portion of the Proceeds of their Bonds.** — Where money has been subscribed by bondholders for a particular purpose, such as the construction of a railroad, and a part of that money has

ers of the bonds and an injury to them, which equity, upon their application, could prevent by injunction. This case was settled by arbitration finally, and a judgment entered in favor of defendants.

[1] Van Weel *v.* Winston (1885), 115 U. S. 228.

[2] Columbus, Hocking Valley, & Toledo Ry. Co. *v.* Burke (Court of Common Pleas, Ohio, 1887), 3 Ry. & Corp. L. J. 26.

[3] Bischoffsheim *v.* Brown (1888), 34 Fed. Rep. 156.

been placed in the hands of trustees,—the duty of such trustees being to pay portions of the money as portions of the road are constructed,—if no such railroad nor any portion of it is constructed, and its construction becomes impracticable, the bondholders are entitled to demand from the trustees repayment of what remains in their hands. The practicability of completing the work is not to be determined solely by physical or financial reasons, but conditions previously stipulated must also be considered.[1]

§ 33. **Lien of Bondholder not lost by Surrender of Bonds.** — A bondholder who surrenders his bonds for the mere purpose of having the indebtedness scaled down, and receives new bonds, leaving a fraction over for which no bond was issued, will be entitled, to the extent of such fraction, to come in on the same footing with other bondholders in respect to his lien.[2]

§ 34. **Bondholders' Right to sue Trustees in Possession for Money received by them.** — Where trustees in possession of the mortgaged property have received money applicable to the bonds, and, instead of paying it over to the bondholders, have diverted it to their own uses and otherwise, a suit in equity will lie against such trustees by and on behalf of all the bondholders for the recovery of such moneys and the removal of the trustees. In such a suit bondholders who have acquired their bonds since the moneys accrued are entitled to share in the recovery, for the

[1] National Bolivian Nav. Co. *v.* Wilson (1880), L. R. 5 App. Cas. 176. In this case a loan was raised to construct a railroad in Bolivia, the loan being raised on the faith of a prospectus which set forth, as a security to the bondholders, the grant of a concession by the government of Bolivia, in virtue of which the bondholders would have the benefit of the customs duties imposed by that government on goods passing along the railroad. The government revoked the concession, and it was held that the loss of the security which the concession had afforded to the bondholders entitled them to treat the scheme as a failure, and to demand the return of their subscriptions. Whether the revocation was rightful or not was declared to be a question which could not be considered by the courts of any other country.

A subsequent case, Collingham *v.* Sloper (1893), L. R. 2 Ch. 96, 54 Am. & Eng. R. R. Cas. 623, involved very similar circumstances, the completion of the road having become impossible, owing to litigation which delayed the realization of the bonds. The unspent portion of the proceeds was administered on the principle that such funds ought to be applied, in the first place, in saving and realizing the property charged, and then distributed among the bondholders.

[2] Blair *v.* St. Louis, H. & K. R. Co. (1885), 23 Fed. Rep. 524. An arrangement for surrender of old mortgage bonds and the scaling of the indebtedness and an issue of new bonds was entered into. No bonds were issued for so small an amount as A.'s fraction amounted to. His equitable lien for this fraction was recognized as equal to that of those who had received the bonds.

reason that such moneys are a part of the security for the debt which passed with it, unless a contrary intention appears.[1]

§ 35. **Conversion of Bonds into Stock.**[2] — Bonds convertible into stock are not as common as formerly, although there are some recent instances of loans on this basis. Where a bond is made "convertible into capital stock at the pleasure of the holder, upon the surrender thereof, with the unpaid interest-coupons, to the secretary of the company," the convertible clause inures to the advantage only of an actual holder. A petition, therefore, which does not aver that the plaintiffs were at the commencement of their action the owners and holders of any of the convertible bonds is fatally defective and demurrable.[3]

A bondholder who has the option of converting his bonds into stock at any time has no right to share in stock issued in lieu of dividends to the persons holding stock prior to the conversion of his bonds. To allow him to do so would amount to giving him interest not only on his bonds, but also on the stock for which he is entitled to exchange them, and would entail the consequence that the longer he delays his election the more stock he would receive.[4]

On the other hand, a charter providing that semi-annual dividends shall be paid on certain days of so much of the profits as the corporation may deem expedient, contemplates that the dividends shall be payable to those parties who are stockholders at the time of making them. Hence a holder of bonds which he converts into stock before the declaration of a dividend is entitled to a proportionate share of such dividend, and the directors have no right to discriminate between him and his associate stockholders. The circumstance that the directors have adopted some particular day as the close of the fiscal year, or selected special days for declaring dividends, or closed the transfer books for any purpose, does not, in any way, impair the legal rights of stockholders to share in dividends subsequently declared.[5]

[1] Dwight *v.* Smith (1882), 13 Fed. Rep. 50.

See, as to distinction between a bondholder's right in an action on the bond itself and his right against a trustee of the mortgage, Dwight *v.* Smith (1881), 9 Fed. Rep. 795.

[2] See also § 30, *ante* (circulars).

[3] Denney *v.* Cleveland, etc. R. Co. (1875), 28 Ohio St. 108. In this case several owners of convertible bonds had assigned to the plaintiff their rights of action for the refusal of the company to comply with a demand for the conversion of their bonds into stock. It was declared that the holder of such bonds could not assign to another the right of action for a breach of the stipulation for conversion, and yet retain the bond for the benefit of himself and his future assignees.

[4] Sutliff *v.* Cleveland, etc. R. Co. (1873), 24 Ohio St. 147.

[5] Jones *v.* Terre Haute, etc. R. Co. (1874), 57 N. Y. 197, Earl and Gray, C. C., dissenting.

The right to convert bonds into stock at the option of the holder is forfeited, if not exercised within the specified period, unless some agreement to the contrary is shown. A simple acceptance by the bondholder of the terms of a circular, in which he is asked to assent to an extension of the time for the payment of the bonds, would possibly be treated as such an agreement; but where the bondholder, in giving his assent, fixes his own terms of acceptance without any reference to the circular, the right of conversion will be deemed to have expired at the date originally named.[1]

Where a bondholder, having the privilege of presenting his bonds at or before maturity for conversion into stock of the corporation, fails to present the bonds and demand conversion until after maturity, his right to receive the stock is forfeited.[2]

Where bondholders have a right under their contract to convert their bonds into stock at any time before maturity, they cannot, upon the consolidation of the company issuing the bonds with another, be deprived of this privilege, and thrown upon the rights conferred upon them by the articles of consolidation, unless, after having received reasonable notice of the proposed consolidation, they have elected to retain their bonds instead of taking the stock they were entitled to.[3]

So a bondholder who is also a stockholder of the company which issued his bonds, and who, as such, takes part in proceedings by which a consolidation with another company is effected, and assents thereto, is bound by all the legal consequences of the consolidation, among which is the inability of the obligor company to create and issue any fresh stock. Any right which he may have up to the time of the consolidation to convert his bonds into stock expires when the consolidation is thus completed with his acquiescence, especially where the statute authorizing the consolidation expressly provides that the consolidated company is to assume the existing contracts and liabilities of the constituent companies, "in such manner as shall be satisfactory to all parties having an interest in the same." Under such circumstances his own assent to what was done precludes him from relying on the principle that the successor to the liabilities of the obligor com-

[1] Muhlenberg *v.* Phila., etc. R. Co. (1864), 47 Pa. St. 16; where an election must be made, see Landis *v.* West Pa. R. Co., 133 Pa. St. 579; s. c. 19 Atl. Rep. 556.

[2] Chaffee *v.* Middlesex R. Co. (1888), 146 Mass. 224; s. c. 16 N. E. Rep. 34.

[3] Rosenkrans *v.* Lafayette, etc. R. Co. (1883), 18 Fed. Rep. 513. See Caley *v.* Cobourg, P. & M. R. & M. Co., 14 Grant Ch. (Can.) 571.

pany ought to respond in damages for the breach of the contract to deliver stock, for the reason that the impossibility of doing so arises from the acts of the obligor company.[1]

§ 36. **Priorities where Old Bonds are exchanged for New.**[2] — There is no principle which forbids a corporation that has issued a series of bonds from purchasing a part of them back and reissuing them again before their maturity, when the financial interests of the corporation will be thereby promoted, unless the organic law of the corporation prohibits the exercise of such a power. It is wholly immaterial whether it pays money upon such a purchase, or exchanges other bonds instead. Nor, if it should destroy the bonds purchased and issue duplicates, not intending to extinguish the debt evidenced by the bonds, will the lien of the mortgage be affected by the substitution of the new bonds.[3]

The contract with the individual bondholder is no more than that he shall have his due proportion of the security implied on the face of the mortgage.[4]

Hence where a company first executes a mortgage to secure a limited number of bonds, and then another mortgage to secure a larger number, the second mortgage reciting that the holders of bonds secured by the first mortgage had agreed to surrender the same, and receive in substitution therefor new bonds to be secured by the first mortgage, as modified by the second, and all the bonds secured by the first mortgage except twenty are exchanged in pursuance of this agreement, the holders of these twenty bonds are not entitled to receive any larger share of the proceeds of a subsequent foreclosure sale than they would have been entitled to had the new bonds not been issued.[5]

So a holder of income bonds who does not surrender his bonds in pursuance of an agreement by which they were to be exchanged for bonds of a new issue, will be restricted in a suit for an accounting to a recovery of the sum which would have been due to him if no bonds had been surrendered.[6]

The State of South Carolina guarantied the payment of certain bonds of a railroad company, to be issued in exchange for outstanding bonds secured by mortgages. The statute authorizing the guaranty provided that the State should take and retain pos-

[1] Taggart v. Northern Central, etc. R. Co. (1868), 29 Md. 557.

[2] As to the exchange of bonds in reorganization proceedings, see Chap. XXXVII.

[3] Barry v. Missouri, etc. Ry. Co. (1888), 34 Fed. Rep. 827.

[4] Claflin v. Railroad Co. (1880), 4 Hughes, 12; s. c. 8 Fed. Rep. 118.

[5] Ames v. New Orleans, Mob. & Tex. R. Co. (1876), 2 Woods, 206.

[6] Barry v. Missouri, etc. Ry. Co. (1888), 34 Fed. Rep. 829.

session of the bonds surrendered and exchanged "as security to the State," the State thereby to be given the lien of the mortgages until the bonds should all be retired. Some bonds were not surrendered and exchanged. It was held that the State could assert her lien for such bonds as she held, together with the coupons thereto attached, with equal rank with the bonds secured by the prior mortgages, but never surrendered and exchanged.[1]

The State of Alabama, as authorized by the legislature, indorsed an issue of bonds of the Alabama & Chattanooga Railroad Company. The strict letter of these statutes not having been conformed to, there proved to be an over-issue of these bonds by the company. The bonds, however, went to *bona fide* purchasers in the markets of the country. An adjustment of the liability of the State to these bondholders was provided for afterwards, and an act passed by the legislature providing for an issue of State bonds to a certain amount, to be exchanged for these old indorsed bonds, the latter to be retired and extinguished. A question was made on the relation of a bondholder as to whether or not under this act the holders of the over-issue of the indorsed bonds, if they could be ascertained, were entitled to have their bonds allowed a benefit in this adjustment of the State's liability. It was held that the holders of the whole issue of bonds, whether or not, shown by the numbering or otherwise, any of them held the over-issue, were entitled to have their bonds retired and extinguished, and to receive the State bonds in exchange for them.[2]

A bondholder who signs an agreement for the purchase of the property of a railroad company by the bondholders and a reorganization, the new company to execute a mortgage and issue bonds to be exchanged for the bonds of the old company, and receives a notice to surrender his bonds for exchange, but fails to do so until after the purchase of the road and the formation of the new company, notwithstanding the agreement bound him to surrender when requested to do so, will have no right to claim any benefits under the agreement, or to insist on the delivery of new bonds.[3]

An intervener in a foreclosure suit claimed that as he had a separate agreement in the matter of a purchase and reorganization of a company, and the exchange of bonds of the old for bonds

[1] Gibbes *v.* Greenville & Columbia R. Co. (1880), 13 S. C. (N. S.) 228; s. c. 4 Am. & Eng. R. R. Cas. 459.

[2] State *ex rel.* Plock *v.* Cobb (1879), 64 Ala. 127; s. c. 7 Am. & Eng. R. R. Cas. 147.

[3] Carpenter *v.* Catline *et al.* (1865), 44 Barb. 75.

of the new, if all the old bondholders did not come into the arrangement, his bonds which had been surrendered should be returned to him, and himself restored to all the rights he originally held, and prayed that his old bonds be restored to him, and that he be paid out of the proceeds of the sale as a creditor under the original mortgages. It was held that he was not entitled to the relief he asked as against purchasers of the bonds who had no notice of his equity.[1]

A railroad company which builds an extension of its line executed a mortgage on such extension which provided that the "trustee may issue bonds secured by these presents, and exchange for an equal amount of the existing outstanding bonds of the [company], which bonds so received in exchange shall be held by said trustee as collateral for the bonds issued under this mortgage until all of said bonds issued by the [company] shall have been surrendered; and when all of said bonds shall have been surrendered, they shall be forthwith cancelled by said trustee."

This provision has been construed by a federal judge to mean that a bondholder exchanging old bonds for new would not have the right, in case all the old bonds were not surrendered and cancelled, to have his old bonds returned to him by the trustee upon his surrender of the new; that the trustee would hold the old bonds as a collateral for such bondholder and other holders; that those who had made the exchange would have the benefit of the new bonds on the extended line of the road not covered by the old bonds, and also the benefit of the old bonds as a collateral for their new bonds.[2]

The surrender of bonds secured by a first mortgage by bondholders, under a reorganization agreement, to their committee, to be held as additional security for them, to be exchanged for bonds of a consolidated mortgage to be delivered to them on a certain contingency which has never happened, is not a transaction prohibited by a statute providing that "no corporation shall issue any bonds or other evidences of indebtedness except for money, labor, or property estimated at its true money value actually received by it, equal to seventy-five per cent of the par value thereof."[3]

Holders of bonds secured by deed of trust upon property which,

[1] Jesup v. Wilmington & Manchester R. Co. (1871), 2 S. C. (N. S.) 469.

[2] Central Trust Co. of New York v. Marietta & North Ga. Ry. Co. *et al.* (Morse, Intervener), 73 Fed. Rep. 589 (1896).

[3] Mowry v. Farmers' Loan & Trust Co. (1896), 76 Fed. Rep. 38, 45.

together with other property not included in such deed, was afterwards mortgaged to secure a subsequent series of bonds, some of which were placed in the hands of a special trustee, "to be applied exclusively for the purpose of discharging the property conveyed from prior liens," are not entitled to have the fund for the payment of their claims increased by means of these bonds in the hands of said special trustee, it being the evident purpose of the deposit of the bonds to put all the debts of the company upon an equal footing, retiring the old and substituting the new bonds, and not to furnish additional security for those already provided for.[1]

Where a railroad company enters into an agreement with the holders of first-mortgage bonds that they are to surrender those bonds and receive in lieu thereof second-mortgage bonds, which are by express stipulation to be subject to a new issue of first-mortgage bonds, the subsequent rights of the parties surrendering the bonds depend upon the agreement; and notwithstanding the failure of the company to perform the agreement to deliver the second-mortgage bonds, they are not entitled to claim the benefit of the lien held by them, prior to the agreement, as assignees of the original issue of first-mortgage bonds. The measure of the compensation for the failure to perform the agreement is the face value of the bonds called for therein.[2]

A bondholder who may have surrendered his bonds under a separate agreement that, if an arrangement for the exchange of old bonds for new is not adopted by all the bondholders, his old bonds should be returned to him, and he be restored to all his rights thereunder, would have no equity, as against purchasers of the new bonds without notice of such agreement, to be restored to his original rights.[3]

§ 37. **Transactions raising the Question whether Bonds have been paid or are still outstanding.**[4] — When a bond is surrendered, and a new bond taken in its place, the new bond will be secured by the mortgage, unless it appears that an extinguishment of the debt was intended.[5]

Where debentures are exchanged for mortgage bonds, the ques-

[1] Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467.

[2] Fidelity Ins. Trust & Safe Deposit Co. *v.* Shenandoah Valley R. Co. (1890), 33 W. Va. 761; s. c. 11 S. E. Rep. 58; 43 Am. & Eng. R. R. Cas. 356.

[3] *Ex parte* White, *In re* Jesup *v.* Wilmington & Manchester R. Co. (1873), 2 S. C. 461. See also Traders' Bank *v.* Lawrence Mfg. Co., 96 N. C. 298, under § 37, below, and cases generally cited under that section.

[4] Compare similar discussion in the case of coupons, Chap. III., below.

[5] Traders' Nat. Bank *v.* Lawrence Mfg. Co. (1887), 96 N. C. 298; s. c. 3 S. E. Rep. 363.

tion whether the former securities are extinguished by the acceptance of the latter depends upon the intention of the parties, as manifested by the agreement in virtue of which the exchange is effected, the stipulations of the bonds, and the provisions of the general mortgage. The conclusion that they are intended to be extinguished is not warranted where the agreement declares "that the lien of the debentures deposited with the trustee of the new mortgage shall be maintained for the security and benefit of the bonds issued under said new mortgage," and several other provisions are inserted which cannot be carried out if the debentures are extinguished.[1]

Where a receiver, in the exercise of the discretion allowed him in the financial manipulation of the assets, takes up bonds and then reissues them, for the purpose of saving interest and meeting the current expenses on the most economical footing, it cannot be assumed that the lien of the bond thereby taken up is destroyed. In the first place, the receiver, as the mere "hand" of the court, is not vested with any such extensive authority to pay a bond, cancel, and then reissue it, deprived of the protection of the original mortgage by which it was made valuable and negotiable. In the second place, it would be extravagant to suppose that a man of ordinary business capacity would advance his money to a corporation the property of which is being administered by a receiver unless he believed himself to be protected by the mortgage. Especially will the court decline to view such bonds as having been retired if the receiver describes them in several annual reports as "first-mortgage bonds then outstanding," and in some of his promissory notes as "first-mortgage bonds past due." Under such circumstances, the actual intent of the receiver is clear, that the purchasers are to take them, upon the reissue, clothed with all the protection to which they were entitled when they were first issued.[2]

Similarly where an embarrassed railroad company, unable to meet its bonded obligations, resorted to funding them in new bonds, and, for amounts under £1,000, issued to the holders of the original bonds certificates of indebtedness for coupons past due, not requiring those receiving them to waive the mortgage

[1] Mobile & Ohio R. Co. *v.* Nicholas *et al.* (1893), 98 Ala. 92; s. c. 12 So. Rep. 723. For a case where old bonds exchanged for new under an agreement were treated as extinguished by the surrender and exchange, see *Ex parte* White, *In re* Jesup *v.* Wilmington & Manchester R. Co. (1873), 2 S. C. 461. For a case where bonds were held not extinguished, see Mowry *v.* Farmers' L. & T. Co. (1896), 76 Fed. Rep. 43.

[2] Gibbes *v.* Greenville, etc. R. Co. (1880), 15 S. C. 304; s. c. 9 Am. & Eng. R. R. Cas. 739.

lien, nor to accept those last-mentioned certificates as payment of the coupons for interest past due, upon the question of the rights of the holders a federal court held that these certificates must be regarded as substituted for the original secured obligations, and not as a novation of the contract, and their holders were entitled to avail themselves of the lien to which the original obligations were entitled.[1]

But the rule that the obligee in the new bond is entitled to the benefit of the mortgage by which the first one was secured is not applicable to a case where the mortgage is actually cancelled and discharged of record, and the adverse claimant is a creditor to whom a debt has been contracted between the time of such cancellation and the execution of a mortgage to secure the new bond.[2]

§ 38. **Effect of Fraud upon Priorities between Bondholders.**[3] — The superior legal title of the holders of first-mortgage bonds will be postponed to that of the holder of second-mortgage bonds, where the latter was induced to accept the position of a subordinate lienor by the fraudulent representation of the former.[4]

Where coupons of outstanding bonds have been dishonored before the bonds came into the hands of one who holds such a large portion of the stock that, in a business point of view, he is himself substantially the company, and therefore interested in floating the residue of the bonds at as high a price as possible, and it is evident that he purchased the bonds with a view to bringing about that result, equity will neither allow him a preference over the purchasers of any bonds thereafter negotiated nor coequal rights with them.[5]

But where the holders of bonds, in placing a portion of them upon the market, and their agent in selling the same have not made any representations, or done anything which would be likely to deceive or defraud the persons purchasing bonds of them, they will not be postponed in the payment of the interest on their remaining bonds until the payment in full of the bonds sold by them; nor will they be so postponed because of their having neg-

[1] Skiddy *v.* Atlantic, Miss. & Ohio R. Co., 3 Hughes, 320 ; s. c. Case No. 12,922, 22 Fed. Cas. 274.

[2] Traders' National Bank *v.* Lawrence Mfg. Co. (1887), 96 N. C. 298; s. c. 3 S. E. Rep. 363.

[3] Compare §§ 78, 79, *post.*

[4] Hooper *et al.* *v.* Central Trust Co. (1895), 81 Md. 559 ; s. c. 32 Atl. Rep. 505. In this case the vendor of land was induced to relinquish his lien as such by an assurance made in behalf of the purchasers that they had sufficient funds to pay for certain betterments which were to be placed on the land, and took second-mortgage bonds in part payment of the price.

[5] Wood *v.* Guarantee T. Co. (1888), 128 U. S. 416.

lected to inform such purchasers of the fact that the mortgagor had failed to keep the interest paid on their bonds.[1]

§ 39. **Priority of Holders of Bonds guarantied by other Holders.** — The priority of a bondholder whose bonds have been guarantied by his co-bondholders cannot be in any way impaired without his consent. A court has therefore no authority to make a decree over an objection of such bondholder directing the trustee to bid in the property on foreclosure for the full amount of the bonded security, inasmuch as the effect of such action would be that he would be deprived of the benefit of his guaranty, and instead thereof would be invested with only his *pro rata* share of the property.[2]

§ 40. **Rights of Income Bondholders.**[3]

(a) *Generally.* — "Income bonds" are a well-known class of securities, deriving their name from the pledge of the income of the corporations issuing them, set out upon their face as the security, and the only security, offered for their payment over and above the general liability of the corporation.

In income bonds the rate of interest is stated, as also the particular income, usually net income out of which they are paid; this is sometimes more specifically stated, and the mode of ascertaining the net income appears on the bond. If cumulative, or payable out of future incomes, in case of deficiency during interest periods, this also must particularly appear on the face of the bond.

It is within the power of a railroad company to mortgage its future net earnings to secure the prompt payment of interest on its construction bonds.[4]

A scheme of reorganization is not fraudulent as against the unsecured creditors, when it provides for giving them, in lieu of their evidence of debt against the old company, preferred income bonds, equal to the amount of their claims, with interest thereon.[5]

[1] Humphreys *v.* Morton (1881), 100 Ill. 592.

[2] Sanxey *v.* Iowa City Glass Co. (1883), 63 Iowa, 707; s. c. 17 N. E. Rep. 429.

[3] See generally, on this subject, 2 Redf. Ry. Law, 528. An interesting article on Income Bonds and Mortgages, by G. W. Field, is to be found in 25 Am. L. Reg. (N. S.) 555 (1886).

[4] Jessup *et al.* Trustees *v.* Bridge *et al.* (1861), 11 Iowa, 572; Dunham *v.* Isett *et al.* (1863), 15 Iowa, 284.

[5] Hancock *v.* Toledo, etc. R. Co. (1882), 9 Fed. Rep. 738; s. c. 11 Biss. 148. In sustaining the agreement for reorganization Judge Blodgett said: "This income bond is, by the terms of agreement, a higher grade of security than the stock of the old company; that is, the stockholders get no dividends until the interest on these bonds is all paid. The stockholders are placed behind the holders of these bonds, and the plan seems to fairly contemplate the protection of all classes of creditors of the old company in the equitable order of their

(b) *Unsecured Income Bondholders, when entitled to a Lien.* — The holders of unsecured income bonds acquire a right enforceable in equity against the property of a company which passes into the hands of a purchaser under the authority of a statute providing for the surrender of the corporate charter when the sale is consummated, and declaring that the purchase "shall in no way affect the rights of the creditors of the company," the presumption from such a clause being that it was introduced for the benefit of unsecured rather than of secured creditors, the latter being already possessed of vested rights of which the legislature could not have deprived them, even if it had undertaken to do so. Under such circumstances the familiar principle is applicable, that, if a corporation is dissolved, or has become so disorganized that it cannot be made answerable at law, a court of equity will follow and lay hold of its property for the satisfaction of its debts, unless that property has passed into the hands of a *bona fide* transferee.[1]

(c) *Rights of Income Bondholders when Purchaser at Foreclosure Sale fails to complete his Purchase.* — The utmost right that income bondholders are entitled to when a company purchasing at a sale under foreclosure of mortgages prior to the income mortgage fails to pay the amount found due to these income bondholders, is the right to redeem from the sale already had, and on failure to redeem within the time limited in the decree their right would be forever barred.[2]

(d) *Suits by Income Bondholders for an accounting, when they lie.* — Under a mortgage to a trustee by a railroad company to secure income bonds by the payment of interest on those bonds at stated periods, out of the surplus earnings of the company, the mortgagor owes a duty to the bondholder to keep such an account of its earnings as will show the net results of each interest period, and the trustee owes an active duty to the bondholders in the supervision of the account.[3]

So, where the interest payable is dependent upon the amount of net earnings as ascertained by the directors, a bondholder can maintain a bill to have the amount justly due for interest ascertained and paid.[4]

priority. It was the evident purpose of the parties to this agreement to place these floating debt-holders in at least as good a relation to the new company as they bore to the old company. They got for their unsecured indebtedness something which at least bears the semblance of a security. It was a second-mortgage bond."

[1] Montgomery & West Point R. Co. *v.* Branch (1877), 59 Ala. 139.

[2] Simmons *v.* Taylor (1889), 38 Fed. Rep. 682.

[3] Barry *v.* Missouri, K. & T. Ry. Co. (1886), 27 Fed. Rep. 1.

[4] Spies *v.* Chicago, etc. Ry. Co. (1887), 30 Fed. Rep. 397, per Wheeler, J.

(e) *Scope of Suits for accounting.* — Where the holder of income bonds, the coupons of which are payable from the "net earnings" and "cumulative," brings suit for an accounting of the net earnings accrued during an interest period for which the company is in default, and brings actions at law for the amount of coupons falling due six and twelve months afterwards, the law suits may be stayed without prejudicing the plaintiff, since he is entitled to an account in the equity suit not merely for net earnings prior to its institution, but also for net earnings received during its progress up to the time the accounts are stated, and all his rights can be protected in that suit.[1]

(f) *Computation of Amount due to Income Bondholders in Suits for an accounting.* — Special amounts chargeable in any one year, as against holders of income bonds drawing non-cumulative interest, must be regulated by what is fair in the interest of all concerned.[2]

The cost of issuing income bonds cannot be charged against income to the prejudice of the holders of the bonds.[3]

Where a plan has been arranged for retiring income bonds by giving in exchange for them other bonds, the bonds surrendered to be held uncancelled until all are retired, a bondholder who did not consent to surrender his bonds could only claim from the income, in an accounting under the mortgage, the share to which he would have been entitled had no bonds been surrendered.[4]

Trustees for bondholders, though the mortgage securing their bonds may cover the income of the road when in possession, through a receiver appointed at their instance, with a condition attached that he pay from the income certain claims for labor, etc., will not be allowed to have appropriated to their bonds out of the earnings in preference to the holders of such labor claims, etc., any of the income, on the ground that the income had been diverted by the receiver for the improvement of the property.[5]

The courts have in many cases treated the mortgaging of the

[1] Morgan *v.* Union Pac. Ry. Co. (1882), 11 Fed. Rep. 692, per Blatchford, J.

[2] Jamaica Ry. Co. *v.* Atty.-Gen. (1893), L. R. C. A. 127. The court adopted a view intermediate between the extreme doctrine that, as the directors of the company were placed in the management of its affairs, the court ought not to interfere with their discretion when they are acting *bona fide*, and the equally extreme doctrine that the account should be taken as if there were to be a periodical stoppage of the business and a recurring winding up.

[3] Jamaica Ry. Co. *v.* Atty.-Gen. of Jamaica (1893), L. R. C. A. 127.

[4] Barry *v.* Missouri, Kansas, & Texas Ry. Co. (1888), 34 Fed. Rep. 829; s. c. 4 Ry. & Corp. L. J. 198.

[5] Union Trust Co. *v.* Souther (1882), 107 U. S. 591.

income, net earnings, etc., of a railroad company as an appropriation of those revenues to the payment of the particular interest on the bonds secured by it, and enforceable as an equitable charge in favor of the bondholders as against all others, such as creditors, for instance, attaching to reach it by process of the courts to the exclusion of the income bondholders.

A railroad company may appropriate its earnings or income to the payment of interest on its bonds, and where this has been done, a court of equity will enforce the lien of the bondholder as an equitable charge upon the earnings or income.[1]

The rule has, however, been different in cases of general mortgages upon the property of all kinds of a railroad company, including the tolls, income, etc., for the security of the general bondholders. In these cases, as long as the mortgagor remains in possession, the claims of judgment creditors or attaching creditors upon such income have been regarded as having a preference.

Where by the terms of a mortgage or trust deed which covers the income of a railroad company until default in the payment of interest on its bonds, the mortgagor is to retain possession of its road and property, and receive the profits and income arising from such use, the income of the company, before possession is taken

[1] Ketchum *v.* St. Louis (1879), 101 U. S. 306, a case where the State of Missouri had a statutory lien, and through its Fund Commissioner controlled the earnings of the Pacific Railroad Company, to secure it against loss by reason of bonds of the State having been issued to aid in its construction. To enable the company to complete its road by a loan of the bonds of the county of St. Louis to a certain extent to the company, a special act was passed by which the State relinquished its lien to that extent upon the earnings of the road, and provided for the payment by the Fund Commissioner, or whatever other person might have charge of the earnings of the company, for the purpose of meeting the interest upon the county's bonds. The act was accepted, and this was held to have amounted to an appropriation of the earnings to this purpose, and to constitute a lien therefor upon those earnings. In Rutten *v.* Union Pacific Ry. Co. *et al.* (1883), 17 Fed. Rep. 480 ; s. c. 16 Rep. 199, the holder of certain bonds of a railroad and telegraph company which had been consolidated with other companies into the defendant company was secured, so far as the interest on the bonds was concerned, by the income of that company from the sale of its land. The bondholder was treated as a creditor, having a specific lien upon the income from the sale of those lands which had gone into the hands of the consolidated company, and allowed to file a bill in equity to enforce his lien after default in the payment of interest on his bonds. In Galena & Chicago Union R. Co., Garnishee, etc. *v.* Menzies (1861), 26 Ill. 122, judgment creditors sought by garnishee process to reach certain income of a railroad company from a contract for transportation of freights, etc. This company had executed a mortgage to trustees for its bondholders, which covered in terms its tolls, incomes, etc. The Illinois Supreme Court held that these revenues were pledged by the trust deed for the payment of the interest and principal of the bonds, and that the trustees were entitled to the money.

by the trustee or mortgagee, will be subject to garnishee process, at the motion of its other creditors.[1]

Though a mortgage may embrace, as part of the security, "income, earnings, moneys," etc., of a mortgagor company, it has been held that the mortgagor, notwithstanding the use of the word "moneys," would not be required to account for moneys received as earnings while in possession, to a mortgagee coming into possession under the mortgage or trust deed.[2]

In holding that the receiver of an insolvent railroad company would not be ordered to pay the interest on certain income bonds which had been issued by an after agreement among the secured and general creditors of the company, the Chancellor of New Jersey thus referred to the bonds: "The exchange of income bonds for stock surrendered was (though that was not the form of the transaction) in effect-creating preferred stock to the extent of the surrender." Again: "The floating debt is a prior claim. Had the usual form of preferring the stock been adopted, the stock would of course have been entitled to no dividends until the debts should have been paid or provided for. The obligation to pay dividends is necessarily subject to the paramount obligation to pay the debts. It is not to be supposed that the parties to the agreement intended to give to holders of the income bonds, for which nothing was paid or to be paid, but which merely represented so much of the stock of the insolvent corporation, a lien

[1] Mississippi Valley & Western Ry. Co. *v.* United States Express Co. (1876), 81 Ill. 534. The court distinguished Galena & Chicago Union R. Co., *supra*, in that the income in that case came to the trustees while they were in possession. It was insisted in Mississippi Valley & Western R. Co. *v.* United States Express Co., *supra*, that as the road of the company passed also through the State of Iowa, the Illinois court should, by comity, be controlled by what it was claimed was a different ruling in that State. The Illinois Supreme Court said: "The ruling in Dunham *v.* Isett *et al.* (1863), 15 Iowa, 284, seems to go to the extent claimed, although the distinction between income received by trustees in possession and income received by the mortgagor before possession taken by the trustees, does not appear to have been discussed in argument or considered by the court." See also Smith *v.* Eastern Railroad Co. & Trustee (1877), 124 Mass. 154; Ellis *v.* Boston, Hartford, & Erie R. (1871), 107 Mass. 1. In Clay *v.* East Tennessee & Virginia R. Co. *et als.* (1871), 6 Heisk. (Tenn.) 421, the court held that an attachment of the tolls, etc., of the company while the road remained in its possession gave the attaching creditor a preference over the trustees named in the deed of trust. In the deed the trustees were given the right to enter into possession in case of default and control the tolls, income, etc., for the payment of the bonds.

[2] Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 768, upon the authority of Galveston Railroad *v.* Cowdrey (1870), 11 Wall. 459, 482, 483; Gilman *et al.* *v.* Illinois & Mississippi Telegraph Co. (1875), 91 U. S. 603, 617; American Bridge Co. *v.* Heidelbach (1876), 94 U. S. 798; Noyes *v.* Rich (1861), 52 Me. 115.

on the annual income for their interest, after paying claims falling due within the year, whatever the amount of other indebtedness of the company might be. On the contrary, it is evident that it was the intention merely to make the interest payable out of money which otherwise would be applicable to the payment of the dividend on the stock at large."[1]

(a) *Out of what Income Interest on Income Bonds is payable.* — Primarily, but not solely, interest is payable out of income of a six months' period. Under a certain mortgage the court laid down the following as the rights of the income bondholders: Unless within some one of the six months' periods between the date and the maturity of the bonds net income should be realized, the company is not in default, and is under no present obligation to pay interest.

This was based upon the promise to pay interest provided the net or surplus earnings should be sufficient therefor.[2]

(b) *Principal secured by Mortgage and not Income.* — It was contended by complainants in this case that the company had no power to lease another road, that the terms of the lease were such that it would absorb the "net earnings" of the company to which they claimed to be entitled by the terms of certain income bonds in the way of interest upon the same, and the bill praying that the company be restrained, etc., the court held that the plaintiffs were simply contract creditors, having no lien or right other than to have their interest paid out of the proper fund, *i. e.* "net earnings;" that the power of the company to change the condition of the road by additions, extensions, or improvements consistent with the purposes of its incorporation was not restricted by the provisions of the bonds referred to; that the parties contem-

[1] Lehigh Coal & Navigation Co. *v.* Central R. Co. of New Jersey (1881), 34 N. J. Eq. 88. In this case the "income bonds" had been used under the agreement for a compromise and settlement of all claims against the company in the hands of a receiver in insolvency proceedings, including bonds, coupons, floating indebtedness, etc., as well as the claims of the stockholders on their stock and a restoration of the property to the company, and given in exchange to the stockholders for their stock which was to be surrendered, and to the holders of floating indebtedness of the insolvent company. New bonds secured by a regular mortgage were given in exchange to holders of bonds and coupons of the insolvent company. The holders of these income bonds, former stockholders, had asked an order from the chancellor for payment of their interest on their income bonds, and the receiver had objected on the ground that there were floating indebtedness coupons still unpaid.

[2] Day *v.* Ogdensburgh & Lake Champlain R. Co. (1887), 107 N. Y. 129; s. c. 13 N. E. Rep. 765, approved in Thomas *v.* N. Y. & G. L. R. Co., 139 N. Y. 163. As to what amounts to an irrevocable assignment to bondholders of the net earnings of a railroad company, see Grand Trunk Ry. *v.* Central Vt. R. Co. (1897), 78 Fed. Rep. 690.

plated a line of active and efficient railroad managed in the usual manner according to the discretion of defendant's directors, not one in suspense or liquidation; and that, therefore, the directors had the right to use the earnings of the corporation for such improvements, or other lawful purposes in its business, as they might think best.[1]

In an equity cause, in which the holders of certain income bonds sought to restrain by injunction the holders of "third-mortgage" bonds which were placed with them by the company to secure advances of money and loans, on the ground that the complainants had an agreement as to further securing their income bonds, the Maryland Court of Appeals saw "nothing in the stipulations of the 'income bonds' which in any way precluded the railroad company from executing other obligations to obtain means to complete their road," and reversed the order granting an injunction. The court evidently viewed the bonds as counsel for the respondents did, who, in his brief, said: "What is the nature of this bond, and what rights and security does it give? The word *income* here means *net income* from the road and its appurtenances. The holder is thus made only a preferred stockholder."[2]

The New Jersey Midland Railroad Company was a consolidated company; its property and franchises were afterwards sold at foreclosure sale, and purchased by a committee of bondholders for the benefit of the bondholders, and such general creditors and stockholders as might choose to unite in a reorganization of the company upon a proposed plan. A part of this proposed plan was to issue "income bonds" to stockholders and holders of certain junior mortgage bonds for their stock and bonds surrendered. T. surrendered certain of these bonds and his stock, and received the new obligations of the Midland Railroad Company of New Jersey, the name of the reorganized corporation. This new company under the general laws of New Jersey effected a consolidation of itself and several other companies, corporations of that and neighboring States, under a new name. T., as the holder of income bonds of Midland Railroad Company of New Jersey, applied to the Supreme Court for leave to file an information in the nature of

[1] Day *et al.* *v.* Ogdensburgh & Lake Champlain R. Co. (1887), 107 N. Y. 129; s. c. 13 N. E. Rep. 765.

[2] Garrett *et al.* *v.* May *et al.* (1862), 19 Md. 177. The "income bonds" in this case were secured on their face by a pledge "in preference to the payment of the dividends on the capital stock" of the company issuing them, of "the income arising from their road and its appurtenances." On the back of them these bonds were declared to be convertible into stock of the company.

a writ of *quo warranto* to determine the validity of this last consolidation. The court, on the idea that such a writ would not lie at the instance of a private relator, denied the leave to T., the holder of the income bonds.[1]

If bonds contain simply a promise to pay interest out of income earned, such a promise would be merely conditional, and in an action on his bond the burden would be upon the holder to show that sufficient income had been earned to warrant the payment of the interest.[2]

An income bondholder may recover in money in an action on his coupons for interest, notwithstanding a provision in the bonds that the company issuing them may, at its option in a certain contingency, issue scrip in payment at the maturity of the coupons, provided the day passes without an election on the part of the company.[3]

§ 41. **Bonds, in what payable.** — A tender of legal-tender notes in payment of coupons attached to bonds made before the Legal Tender Act has been held good. It was claimed that the tender should have been made in gold and silver coin.[4]

It has been held in a particular case that it was the intention of the railroad company that the principal of its bonds should be

[1] In the matter of Terhune, Applicants, etc. *v.* Potts *et al.* (1885), 47 N. J. L. 218; s. c. 23 Am. & Eng. R. R. Cas. 754.

[2] Corcoran *v.* Chesapeake & Ohio Canal Co. (1874), 1 MacArthur (D. C.), 358.

[3] Marlor *v.* Texas & Pacific R. Co. (1884), 21 Fed. Rep. 383; s. c. 22 Blatch. 464, affirmed in Texas & Pacific R. Co. *v.* Marlor (1887), 123 U. S. 687. The bonds on which this action was brought were secured by mortgage on lands granted to the company and the income of the road. There was a provision in them that in case the net earnings were not sufficient to pay the interest coupons as they became due, the company might, at its option, issue scrip, which was to be receivable for purchase-money of any of the lands at the ordinary schedule price, in payment of the interest on the bonds. This provision was construed and a judgment in money rendered for the interest due and unpaid, as appeared by the coupons, it being shown that the company had allowed the day of the maturity of these coupons to pass without exercising their option to pay in scrip. This case was approved by the Supreme Court of Judicature of Massachusetts when it held that, in an action to recover interest on a bond of a corporation which contained an absolute promise to pay interest on certain specified days, the burden of proof was not upon the holder of the bond to show that income had been earned to warrant the payment of interest. Strauss *v.* United Telegram Co. (1895), 164 Mass. 130, 132, 133; s. c. 41 N. E. Rep. 57.

[4] Railroad Company *v.* Johnson (1873), 15 Wall. 195; s. c. 21 L. ed. 178. See Cheever *v.* Rutland & Burlington R. Co. (Vt., 1869), 4 Am. Ry. Rep. 291, 311, declining to make a decree for payment of railroad bonds in gold, the court adhering to its opinion of the constitutionality of the Legal Tender Act. On contracts to pay in gold coin, see 30 Am. Law Rev. 907, 950; 15 N. Y. Law Journal, 508, May 18, 1896; Woodruff *v.* State of Mississippi, 162 U. S. 281; 53 Alb. L. J. 292, May 9, 1896; N. Y. L. J., Feb. 13, 1896; 2 Woods, 614. See also Castle *v.* Kupena, 5 Hawaiian Rep. 27.

paid in lawful money instead of Confederate notes, and that the interest must follow the character of the principal.[1]

The Supreme Court of North Carolina have, however, held a railroad bond executed in North Carolina in 1862 to come within the provisions of an ordinance of the Convention of 1865, and presumably to be solvable in money of the value of Confederate currency, subject to evidence of a different intent by the parties.[2]

But a different intent would not be implied from a provision in the charter that the company may make contracts for building the road, and may pay contractors in bonds at par value.

It has also been held that a claim that payment of bonds should be made in gold coin must rest upon a contract to that effect.[3]

Where bonds, as prepared and issued, promise payment in lawful money, a stipulation afterwards indorsed by the corporation upon them that they shall be paid in coin, this being required of it by the purchasers of the bonds, would bind the corporation only, and not a State which had guarantied the payment of those bonds previous to this indorsement.[4]

The Missouri Supreme Court has held that railroad State bonds issued for the construction of railroads payable on their face "in gold and silver" were obligations for payment in coin, but that as the legislature had ordered the State agents to pay the same in legal-tender notes, and it was competent for it so to do, no writ of *mandamus* could be issued to compel a payment in coin.[5]

In Johnson *v.* Norwich & Worcester R. R. Co.,[6] a case reserved for advice, the Supreme Court of Connecticut advised (1) That, upon the authority of the U. S. Supreme Court's decision as to the unconstitutionality of the Legal Tender Act, a petitioner for foreclosure on bonds issued before the Legal Tender Act was passed, was entitled to payment of the bonds and coupons in coin; (2) That he was entitled to have such proportion of the stock of another corporation held in trust for the security of these bonds, as the amount of his bonds bore to the whole amount secured, sold, and the net avails converted into coin and paid over to him, to be applied upon the coupons and bonds; (3) That

[1] Atlantic, Tennessee, & Ohio R. Co. *et al.* *v.* Carolina National Bank (1874), 19 Wall. 548; s. c. 22 L. ed. 196.

[2] Alexander *v.* Atlantic, Tennessee, & Ohio R. Co. (1872), 67 N. C. 198.

[3] Maryland *v.* Railroad Company (1871), 22 Wall. 105; s. c. 22 L. ed. 715.

[4] Wallace *v.* Loomis (1877), 97 U.S. 146.

[5] State *ex rel.* *v.* Mays *et al.* (1872), 50 Mo. 34.

[6] 37 Conn. 433 (1870).

for any balance remaining unsatisfied a decree should be passed foreclosing the mortgage unless such balance should be paid in coin ; (4) That there was no principle upon which the payment of the bonds and coupons could be decreed to be made in currency to an amount equal to the currency value of the gold on the day when the bonds fell due, but that payment must be decreed in coin itself.

§ 42. **When Principal of Bonds becomes due.** — *Bonds not becoming due till Original Date of Maturity.* — A clause in a mortgage providing that in no case should the principal of any bond be considered due until twenty years after its date, has been held to have been inserted merely to exclude any possible inference that a bondholder, under any circumstances, might bring an action for the principal of a bond before it became due by its terms. The same mortgage provided that in case of default in payment of interest or principal of any bond, and a sale or other proceedings to coerce the same, all bonds which should be a lien in common therewith, and the interest accrued thereon, should be considered, and should in fact be equally due and payable and entitled to a *pro rata* dividend of the proceeds of such sale or other proceedings. The court below had provided for payment of overdue interest-warrants to the exclusion of the principal of the bonds.[1]

Where there is no stipulation that the principal shall become due by the non-payment of the interest, the lien cannot be so enforced as to compel the payment of the principal, on default in the payment of the interest.[2]

§ 43. **Legislature cannot accelerate Maturity of Principal.** — Where trustees who can elect that the principal should become immediately due upon default of principal or interest have not exercised the right of election, a legislature cannot, by an act subsequently passed, authorize the sale of the railroad property free from the mortgage, for the reason that the effect would be to make a loan of money become due before the time fixed in the contract, and it could not be enforced.[3]

§ 44. **Contract held not to entitle Company to pay off Bonds before Maturity.** — A traffic contract indorsed upon the bonds, whereby the mortgagor stipulates that another railroad shall retain complainant's share of the earnings under the contract, and pay them

[1] Dunham *v.* Cincinnati, Peru, etc. Ry. Co. (1864), 1 Wall. 254.

[2] State of Florida *v.* Anderson *et al.* (1875), 91 U. S. 667.

[3] Randolph *et al.*, Trustees, *v.* Middleton (1875), 26 N. J. Eq. 543. A proceeding against the railroad company under the New Jersey act as an insolvent corporation.

over semi-annually to a trustee to be applied to the "ultimate redemption" of the bonds, such contract to continue in force for thirty years, or "for so long a time as will be sufficient to provide a fund large enough to redeem all of the bonds," does not give the railroad company the right to pay off the bonds as soon as a fund sufficient for that purpose has accumulated. The mere fact that the parties have agreed in this manner, that a fund shall be created for the payment and redemption of the bonds, does not involve the inference that they necessarily contemplate that the fund shall be applied to that purpose as soon as it is of sufficient amount to discharge the debt.[1]

§ 45. **Acceleration of Maturity as Result of Default in Payment of Interest.** — It is usual for the bonds and mortgage to provide that a default in payment of interest shall cause the principal to become due and payable.[2]

An indirect result of such a provision is illustrated by a case in Illinois, which, in an action to recover the price of three bonds of the company under a contract by which defendant agreed to take five of those bonds at a fixed sum per bond, and had already accepted and paid for two, held that the payment of the interest upon those two bonds was a vital part of the contract with defendant, and that under the provision in the mortgage that, upon default of the interest upon those bonds for ninety days after becoming due, the entire principal and interest coupons should become immediately due, the effect of failure to pay the interest on those bonds for ninety days was that the bonds became due to defendant. He was therefore allowed to recoup for the sum due upon them against the damages claimed of him for his refusal to accept and pay for the others.[3]

The provision for a sale under a power for default in payment of interest, and application of proceeds of sale, after payment of overdue interest, to payment of principal, though not yet due, does not accelerate time of payment of principal. The mortgagor can prevent a sale by payment of interest only.[4]

§ 46. **Acceleration of Maturity of Principal at Option of Individual Bondholders or Trustees.** — The provision most commonly found in mortgages with regard to the acceleration of the maturity of the principal is that in case of default of interest for six months

[1] Chicago, E. I., etc. R. Co. *v.* Pyne (1887), 30 Fed. Rep. 86.

[2] Cases dealing with such a provision are reviewed in the chapter on Foreclosure, *post.*

[3] Galena & Southern Wisconsin R. Co. *v.* Barrett (1880), 95 Ill. 467; s. c. 2 Am. & Eng. R. R. Cas. 520.

[4] Chicago, etc. R. Co. *v.* Fosdick (1881), 106 U. S. 47.

after demand the principal shall become due at the option of the holders of a majority in interest.[1]

A provision that default of interest for sixty days after demand makes the principal "subject to become due and payable" has been construed to mean subject to become so at the option of the holder. The bill must show that the petitioner has elected to have the bonds become due.[2]

In foreclosure proceedings of a junior mortgage, the bondholders having elected to treat the default in the payment of interest as a forfeiture of the contracts so far as they prescribed the length of time for which the bonds were to run, this election on their part operates *prima facie* to cancel all coupons representing interest not then due; and, unless the mortgaged property shall be sold subject to one or more of the elder mortgages, this election should be regarded as having precipitated the payment of the principal sums, and they would bear interest at the agreed rate per annum.[3]

In an action to recover railroad bonds which had been stolen and sold to defendant, the question arose as to whether these bonds were overdue when purchased. Construing a provision in the bonds, that, in case of the continuance for six months of a default in the payment of interest, or in contributing to a sinking fund, "the principal shall, without further demand or notice, become due or payable from and after the expiration of six months from the date of such default," the court held that (1) as the default had occurred, proceedings to foreclose the mortgage showed an election to have the bonds become due, if such an election was necessary, and the bonds were overdue when stolen; (2) that there was no evidence of a waiver of the election to have them become due, as, although some portion of past-due coupons was paid to this plaintiff, the bondholder, pending the foreclosure of the mortgage, it was in accordance with some provision of the mortgage, and was not a waiver of such election.[4]

As to the effect upon the contract of apparently variant provisions in a mortgage that the bonds were payable in twenty years from date, and that bondholders might elect to have them mature upon default as to interest for a fixed period, the

[1] See, for example, the mortgages construed in Union Trust Co. of New York *v.* Missouri, etc. Ry. Co. (1880), 26 Fed. Rep. 485, and in the cases cited *post*, in the chapter on Foreclosure.

[2] Rutten *v.* Union Pac. Ry. Co. (1883), 17 Fed. Rep. 480.

[3] Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush (Ky.), 673; s. c. 18 Am. Ry. Rep. 221.

[4] Northampton Bank *v.* Kidder *et al.* (1887), 106 N. Y. 221, distinguishing Railway Co. *v.* Sprague, 103 U. S. 756, and Morgan *v.* United States, 113 U. S. 476.

Supreme Court of Connecticut has expressed its opinion as follows: "The provision that the bond should continue for twenty years an outstanding subsisting security, if any existed, was with reference to the corporation. The provision that the bonds by the action of the bondholders might mature before that time was in reference to the co-bondholders. And while it would impair the obligation of a contract, if such contract existed, so far as the corporation is concerned, to change the time of maturity, it does not have that effect when the co-bondholders proceed upon their common and undisputed right to cause the bonds to mature, and by foreclosure to discharge the bonds by taking the property in a legal way."[1]

Exercise of Option to become due, accompanied by Restriction on Right to foreclose. — In a case where the provision was that, after the principal of the bonds had been declared by the trustees to have become due by reason of the default, and the mortgagor notified thereof, the trustees, "upon the written request of the holders of a majority of the said bonds then outstanding, shall proceed to collect both principal and interest of all said bonds outstanding by foreclosure and sale of said property, or otherwise as herein provided," it was held that, "even had the trustees rightfully declared the principal sum of the mortgage debt due, and given the proper notice thereof, nevertheless the foundation of a proceeding to foreclose for that cause and of the decree requiring payment of that amount would fail, without proof that the bill had been filed for that purpose, upon the written request of the holders of a majority of the bonds then outstanding." In thus construing the mortgage the court says: "In declaring the principal sum due before the date fixed by the credit upon a default in the payment of interest, the trustee is acting for the whole number of bondholders, and the provision that subjects his action, in enforcing the stipulation, to the wishes of a majority, is meant, as we think, for the protection of the class. Many cases may be mentioned to illustrate the importance in their interests of such a control, rather than to put it in the power of one or a minority to require all to accept what the majority might consider to be a premature and less valuable satisfaction for their existing security. The larger number might think it to their advantage even to defer the collection of their overdue interest, much less not to anticipate the payment of the principal, even when the security was ample to meet both, for they might esteem the ultimate investment higher than present

[1] Gates *v.* Boston & N. Y. Air Line R. Co. (1885), 53 Conn. 333; s. c. 24 Am. & Eng. R. R. Cas. 143.

payment, and while they could not and ought not to prevent others, even a single individual, from exacting the promptest payment of what is due, and may be important as current income, by legal process, they may nevertheless rightfully object to an anticipation of payment that may in their opinion prove to be a sacrifice; and this becomes especially important when the present value of the security is insufficient to prepay the incumbrance, but contains the solid promise of future indemnity or an investment. It is that interest, we think, that dictated the clause in question, and can be satisfied only by the construction which secures to the majority of the bondholders the right to veto the proceeding of the trustees."[1]

§ 47. **Sales of pledged Bonds.**[2] — Where by the contract a definite time is fixed for the payment of the debt, a sale of the pledge may be made without notice or demand; and where bonds are pledged as security for the payment of acceptances, the time when the pledgee may sell the bonds is determined by the maturity of the note, and not of the acceptances. And while, as a general rule, the pledgee cannot buy the pledged property at his own sale, this rule may be waived by express agreement of the parties.[3]

Where the pledgee of bonds assigns them as collateral security for a debt of his own, and the assignee forecloses against the original pledgor, and buys in the bonds himself, he must account to the assignor for the bonds or their value, and not merely for the amount paid by him at the foreclosure sale.[4]

A bill in equity may be maintained to redeem bonds pledged, if an accounting is wanted, or if there has been an assignment of the pledge. This right is not cut off by the foreclosure of the mortgages executed to secure these bonds.[5]

§ 48. **Payment of Income Tax by Bondholders.** — A provision in the mortgage that the debt and interest shall be paid "without any deduction, defalcation, or abatement to be made of anything for or in respect of any taxes, charges, or assessments whatsoever," does not oblige the company to pay the interest on its bonds which, by section 122 of the Revenue Act of 1864, such companies "are authorized to deduct and withhold from all payments on account of any interest or coupons due and payable." Such a

1 Chicago, etc. R. Co. *v.* Fosdick (1881), 106 U. S. 47.

2 As to the status of purchasers at sales of pledged bonds, see § 67, *post.* This section is inserted here, though its subject is not within the general scope of the book.

3 Chouteau *v.* Allen (1879), 70 Mo. 290.

4 First Nat. Bank *v.* Ohio Falls Car & Locomotive Works (1884), 20 Fed. Rep. 65.

5 White Mountains R. Co. *v.* Bay State Iron Co. (1870), 50 N. H. 57; s. c. 1 Am. Ry. Rep. 158.

provision is inserted to secure the mortgagee, who may not be in possession, from a demand for taxes incurred while the mortgagor is in possession, and has no application to the income tax of bondholders.[1]

ARTICLE II. — RIGHTS OF BONDHOLDERS INVOLVING THE NEGOTIABLE CHARACTER OF SUCH BONDS.

§ 49. **Negotiable Character of Corporate Bonds generally.** — It is now well settled by the overwhelming weight of authority in this country that a corporate bond in the usual form is, though under seal, a negotiable instrument entitled to all the privileges of commercial paper.[2]

In Jackson *v.* York & Cumberland R. Co.[3] the court adhered

[1] Haight *v.* Railroad Co. (1867), 6 Wall. 15. See also Cleveland, etc. R. Co. *v.* Penn., 15 Wall. 300; s. c. 4 Am. Ry. Rep. 368; Jackson *v.* Northern Central Ry. (1868), Chase's Dec. 268; Haight *v.* Pittsburg, etc. Ry. Co. (1867), 1 Abb. 81; United States *v.* Erie Co. (1877), 9 Ben. 67.

[2] White *v.* Vermont & Massachusetts R. Co. (1858), 21 How. 575; Zabriskie *v.* Cleveland, Col. etc. R. Co. (1859), 23 How. 381; Kneeland *v.* Lawrence (1891), 140 U. S. 209; Chicago Ry. Equipment Co. *v.* Merchants' Bank (1890), 136 U. S. 268; Gelpcke *v.* Dubuque (1863), 1 Wall. 175; Clark *v.* Iowa City (1874), 20 Wall. 583; Aurora City *v.* West (1868), 7 Wall. 82; Mercer Co. *v.* Hacket (1863), 1 Wall. 83; Knox Co. *v.* Aspinwall (1858), 21 How. 539; Reid *v.* Bank of Mobile (1881), 70 Ala. 199; Blackman *v.* Lehman (1879), 63 Ala. 547; Lehman *v.* Tallassee Mfg. Co. (1879), 64 Ala. 567; Town of Eagle *v.* Kohn (1876), 84 Ill. 292; Junction Railroad Co. *v.* Cleneay (1859), 13 Ind. 161; New Albany, etc. Plank Road Co. (1864), 23 Ind. 353; Griffith *v.* Burden *et al.* (1872), 35 Iowa, 138; State of Virginia *v.* State of Maryland (1870), 32 Md. 501; Haven *v.* Grand Junction Railroad & Depot Co. (1871), 109 Mass. 88; Chapin *v.* Vermont & Massachusetts R. Co. (1857), 8 Gray (Mass.), 575; Craig *v.* City of Vicksburg (1856), 31 Miss. 216; Hackensack Water Co. *v.* De Kay (1883), 36 N. J. Eq. 548; Morris Canal & Bkg. Co. *v.* Lewis (1858), 12 N. J. Eq. 323; Boyd *v.* Kennedy (1875), 38 N. J. L. 146; Morris Canal & Bkg. Co. *v.* Fisher (1855), 9 N. J. Eq. 667; Hubbard *v.* New York, etc. R. Co. (1862), 36 Barb. 286; Brainerd *v.* New York, etc. R. Co. (1862), 25 N. Y. 496; Dinsmore *v.* Duncan (1862), 57 N. Y. 573; Connecticut, etc. Ins. Co. *v.* Cleveland, etc. R. Co., 41 Barb. 9; Blake *v.* Board of Commrs. of Livingston Co. (1871), 61 Barb. 149; Welch *v.* Sage (1872), 47 N. Y. 143; Hodges *v.* Shuler (1860), 22 N. Y. 114; National Exch. Bank *v.* Hartford, etc. R. Co. (1866), 8 R. I. 375; American Nat. Bank *v.* American, etc. Co. (1895), 32 Atl. Rep. 305; Langston *v.* South Carolina R. Co. (1870), 2 S. C. 248; *Ex parte* Williams (1882), 18 S. C. 299. Even a writing which does not contain a direct promise to pay money, but only a promise to give security for money, such as the scrip issued by European governments, entitling the holders to an equal amount of bonds to be afterwards issued, will be treated as negotiable paper, if the usage of the monetary world has given it that character. Goodwin *v.* Roberts (1875), L. R. 10 Exch. 337. This case combats with great force of reasoning, and an imposing array of authorities, the narrow view that the law merchant is fixed and stereotyped, and incapable of being enlarged so as to meet the wants and requirements of trade in the varying circumstances of commerce.

[3] 48 Me. 147 (1858).

to the strict common-law rule that bonds, being specialties, were not legally assignable, so that a suit could be sustained in the name of an assignee. But this case and the somewhat similar one of Myers *v.* York & Cumberland R. Co.[1] cannot be regarded as authority outside the State. Apparently they have not been overruled in that State.

A clear and authoritative statement of this rule will be found in the opinion of the court in White *v.* Vermont, etc. R. Co., quoted below.

The cautious doctrine of some cases is that these bonds are not strictly negotiable under the law merchant, as are promissory notes and bills of exchange, and the rights of the holders are based upon the theory that they are instruments of a peculiar character, and being expressly designed to be passed from hand to hand, and by common usage actually so transferred, are capable of passing by delivery, so as to enable the holder to maintain an action on them in his own name.[2]

But this seems to be an unnecessary refinement. A simpler and more accurate view is that the necessities of commerce and the customs of the financial world have imparted to these instruments the quality of negotiability, in spite of technical rules of law, and that the law merchant has taken them under its protection in deference to precisely the same conditions as those which have, from a much more remote period, secured for ordinary bills and notes the well-known and distinctive privileges which place them in a class apart from *choses in action* generally. As was well said by Nelson, J., pronouncing the decision of the Supreme Court of the United States to this effect in White *v.* Vt. & Mass. R. Co., *supra:* "We think the usage and practice of the companies themselves, and of the capitalists and business men of the country dealing in them, as well as the repeated decisions or recognition of the principle by courts and judges of the highest respectability, have settled the question. Indeed, without conceding to them the

[1] 43 Me. 232 (1857).

[2] Carr *v.* LeFevre (1856), 27 Pa. St. 413, cited with approval in the later case of Bunting's Admr. *v.* Camden, etc. R. Co. (1876), 81 Pa. St. 254; s. c. 15 Am. Ry. Rep. 570, where it was held that bonds payable to A. or his assigns were within the act of May 28, 1715, and that a holder other than the obligee could not sue thereon in his own name without proving that the assignment had been made under the hand and seal of the assignor before two or more credible witnesses. The negotiability of bonds is also accounted for in the same way in two early New Jersey cases. Morris Canal, etc. Co. *v.* Fisher (1855), 9 N. J. Eq. 667; Morris Canal, etc. Co. *v.* Lewis (1858), 12 N. J. Eq. 323. See Williams *v.* Sidmouth Ry. & Harbour Co., L. R. 2 Exch. 284, suit in the name of obligee on an assigned "Lloyd's bond."

quality of negotiability, much of the value of these securities in the market, and as a means of furnishing the funds for the accomplishment of many of the greatest and most useful enterprises of the day, would be impaired. Within the last few years large masses of them have gone into general circulation, and in which capitalists have invested their money; and it is not too much to say that a great share of the confidence they have acquired, as a desirable security for investment, is attributable to this negotiable quality, as well on account of the facility of passing from hand to hand, as the protection afforded to the *bona fide* holder."[1]

In England it has been held that debenture bonds payable to bearer, whether they should properly be called promissory notes or not, are at all events negotiable instruments, because the contents of such an instrument amount to a representation by the company to all the world that it will, at the expiration of the period for which they are to run, pay the sum for which they are given to the holder, together with interest half-yearly in the mean time.[2]

The feature common to these and all other instruments that have been adjudged to be negotiable is that they are in some form

[1] So also the same court, through Mr. Justice Grier, in Mercer County *v.* Hacket, 1 Wall. 83, 95, has said, speaking of municipal bonds: "This species of bonds is a modern invention, intended to pass by manual delivery, and to have the qualities of negotiable paper, and their value depends mainly upon this character. Being issued by States and corporations, they are necessarily under seal. But there is nothing immoral or contrary to good policy in making them negotiable, if the necessities of commerce require that they should be so. A mere technical dogma of the courts on the common law cannot prohibit the commercial world from inventing or using any species of security not known in the last century. Usages of trade and commerce are acknowledged by courts as part of the common law, although they may have been unknown to Bracton or Blackstone. And this malleability to suit the necessities and usages of the mercantile and commercial world is one of the most valuable characteristics of the common law. When a corporation covenants to pay to bearer, and gives a bond with negotiable qualities, and by this means obtains funds for the accomplishment of the useful enterprises of the day, it cannot be allowed to evade the payment by parading some obsolete judicial decision that a bond for some technical reason cannot be made payable to bearer." See also Guilford *v.* Minneapolis, St. Marie, & A. R. Co., 48 Minn. 561; s. c. 51 N. W. Rep. 658; 51 Am. & Eng. R. R. Cas. 98.

[2] *In re* Imperial Land Co. of Marseilles (1870), L. R. 11 Eq. 478; *Ex parte* City Bank, L. R. 3 Ch. 758. The English debenture-bonds vary considerably in form, and the decisions bearing on their negotiability are for this reason less valuable as precedents to the American lawyer. It has been considered advisable to abstain from noticing in the present work the English cases turning upon language not found in the corporate securities of this country, and not illustrating general principles. Debentures subject to a condition, as that a certain number of them are to be drawn and paid off every half-year, are not promissory notes. Crouch *v.* Credit Foncier of England, Lim. (1873), L. R. 8 Q. B. 374. See Young *v.* McNider (1895), 25 Sup. Ct. (Can.) Rep. 272.

the representative of money, and may be satisfied by payment in money at a time specified.[1]

§ 50. **Bonds not non-negotiable, because no Payee is named.** — The fact that a bond is issued with a blank for the name of the payee does not make it any the less a negotiable instrument. The authority of a subsequent *bona fide* holder writing his own name in the blank space, and making the instrument complete, is implied from the act of the obligors in putting it in circulation in that condition.[2]

In putting such an instrument on the same footing, as regards negotiability, with ordinary commercial paper, the courts of this country have, for reasons of public policy, departed from the technical rule of common law that a bond executed with a blank for the name of the payee is void, and that the authority of an agent to fill a blank in an instrument, and thus make it the valid deed of his principal, must be conferred by deed.[3]

§ 51. **Uncertainty in Time of Payment or Amount as affecting Negotiability.** — (a) *What is not an Uncertainty in the Time of Payment destructive of Negotiability.* — Provided a bond is payable at a fixed date, its negotiability is not destroyed by the insertion of a clause reserving to the obligor the option of discharging the obligation at any time prior to that date;[4]

[1] Mechanics' Bank *v.* New York & New Haven R. Co. (1856), 13 N. Y. 599, denying negotiability on this ground to shares of stock. Similar language may be found in Craig *v.* City of Vicksburg (1856), 31 Miss. 216. Compare also the opinion of Lord Tenterden in Wookey *v.* Pole, 4 B. & Ald. 1. "Abstracted from authority, I think this instrument (an exchequer bill) is of the same nature as notes and bills of exchange. Like them it is neither valuable nor useful in itself as goods and chattels, such as a horse, a book, a picture, or a pipe of wine are. It is valuable only as entitling the holder to receive, at some future time, a certain sum of money, which is a value precisely of the same nature as the value of a note or bill." The same judge, speaking of bonds issued by the King of Prussia, said: "This instrument, in its form, is an acknowledgment by the King of Prussia that the sum mentioned in the bond is due to every person who shall, for the time being, be the holder of it. And the principal and interest is payable in a certain mode, and at certain periods, mentioned in the bond. It is, therefore, in its nature precisely analogous to a bank-note payable to bearer, or to a bill of exchange, indorsed in blank." Georgier *v.* Mieville (1824), 3 B. & C. 45. See also Evertson *v.* National Bank (1876), 66 N. Y. 14, and the elaborate judgment of Chief Justice Cockburn in Goodwin *v.* Robarts (1875,) L. R. 10 Q. B. 337.

[2] Boyd *v.* Kennedy (1875), 38 N. J. L. 146, citing White *v.* Vermont & Massachusetts R. Co. (1858), 21 How. 575; Brainerd *v.* New York & New Haven R. Co. (1862), 5 N. Y. 496; Hubbard *v.* New York & Harlem R. Co. (1862), 36 Barb. 286; Chapin *v.* Vermont & Massachusetts R. Co. (1857), 8 Gray, 575, as illustrations of the same doctrine.

[3] Cases asserting this common-law rule are Hibblewhite *v.* McMorine, 6 M. & W. 200; Enthoven *v.* Hoyle, 13 C. B. 373; Squire *v.* Wilton, 1 H. L. C. 333.

[4] Union L. & T. Co. *v.* Southern Cal. Motor Road Co. (1892), 51 Fed. Rep. 840. This case was decided with special refer-

nor by the fact that the bond is made subject to the condition of an agreement between the obligor and a trust company, whereby it is provided that a sinking fund of not less than $50,000 nor more than $100,000 in each year shall be applied to the purchase or drawing at par of said bonds, and that the whole issue may be drawn at par on "a given date, or any coupon day thereafter;" [1] nor by a provision that, if any of the payments of interest cannot be made at the dates named, all interest due shall be paid as soon thereafter as sufficient money has been earned to enable the company to do so.[2]

(b) *When the Amount is uncertain so as to render the Bond non-negotiable.* — Where by the terms of the bond the amount payable remains uncertain until the place of payment is fixed by the indorsement of the president of the obligor company, the bond is not a negotiable instrument until the requisite indorsement is made.[3]

§ 52. **On the Law that governs the Question of Negotiability.** — The mere fact that an instrument is negotiable by the law of one country will not invest it with the quality of negotiability in another country. The question of its negotiability must be determined with reference to the law or custom of the country in which the action on the instrument is brought.[4]

Foreign bonds, however, will be treated by the courts as negotiable instruments, if it is shown that they are customarily circulated as such among merchants and men of business.[5]

§ 53. **Who are Bona Fide Holders of Bonds generally.** — For a general discussion of the question what constitutes a *bona fide* holder, reference will, of course, be had to treatises on negotiable instruments. The cases cited in this and the following sections are inserted merely to illustrate the application of principles of negotiability to transfers of corporate securities.

A bondholder who testifies that he purchased his bonds for a price named in good faith in the open market, supposing them to be the valid obligations of the company, and being told that they were, will be held a *bona fide* holder for value.[6]

ence to the Civil Code of California, §§ 3087–3089, 3093; but those provisions are merely declaratory of the rules of common law.

[1] Union Cattle Co. *v.* International Trust Co. (1889), 149 Mass. 492; s. c. 21 N. E. Rep. 962. The court held the bond negotiable both under the statute (Pub. St., c. 77, § 4) as well as by custom.

[2] Strauss *v.* United Telegraph Co. (1895), 164 Mass. 130; s. c. 41 N. E. Rep. 57.

[3] Parsons *v.* Jackson (1878), 99 U. S. 434.

[4] Ricker *v.* London, etc. Bkg. Co. (1887), L. R. 18 Q. B. D. 515.

[5] Venables *v.* Baring (1892), L. R. 3 Ch. Div. 527.

[6] Galveston, etc. R. Co. *v.* Cowdrey (1870), 11 Wall. 459.

The rule is not disputed that bonds in the hands of a holder acquiring them for value, before due, without notice, are not subject to the equities with which they were affected as between the original parties or while in the hands of a party holding them.[1]

The transferee of a coupon bond is presumed to be a *bona fide* holder for value,[2] and the transferee of a *bona fide* purchaser of bonds, even if he has notice of equities between the obligor and the obligor's original assignee, is himself protected as a *bona fide* purchaser.[3]

And the possession of a negotiable bond, being strong *prima facie* evidence of just title in ordinary cases, throws upon the party questioning it the burden to show that the holder had notice of some vice or defect which would vitiate his title.[4]

As the mortgage security is a continuing one, and the bonds are negotiable by the company in such a sense as to carry the mortgage security until they have become commercially dishonored, or something else has been done to deprive the company of the power of putting them out, a dealer who finds bonds of a given series in the hands of a company, with the certificate of the trustee upon them, may buy in good faith with safety. The execution of a junior mortgage is not sufficient to deprive one who thereafter purchases from the company bonds secured by a prior mortgage of his privileges as a *bona fide* holder, unless the junior mortgage in terms limits the lien of the prior mortgage to bonds actually disposed of, and probably not even then. It might fairly be held that the junior mortgagee is guilty of a commercial wrong in not protecting himself and the public by refusing to accept his security until the remaining bonds of the earlier series are cancelled, and should be made to suffer accordingly.[5]

Persons doing work for, or furnishing material to, a railroad company receiving its bonds therefor are *bona fide* holders of the same as much as if they had paid cash for them.[6]

[1] Reid *v.* Bank of Mobile (1881), 70 Ala. 199; s. c. 14 Am. & Eng. R. R. Cas. 554.

[2] Gibson *v.* Lenhart (1882), 101 Pa. St. 522. See also Morris Canal & Bkg. Co. *v.* Fisher (1855), 9 N. J. Eq. 667; Same *v.* Lewis (1858), 12 N. J. Eq. 323; Carpenter *v.* Rommel (1862), 5 Phil. 34; Gilbough *v.* Norfolk & P. R. Co. (1877), 1 Hughes, 410.

[3] Morris Canal, etc. Co. *v.* Lewis (1858), 12 N. J. Eq. 323; Union L. & T. Co. *v.* Southern Cal. Motor Road Co. (1892), 51 Fed. Rep. 840. Cases illustrating who are *bona fide* purchasers: Tyrell *v.* Cairo & St. L. R. Co., 7 Mo. Ap. 294; Galveston Railroad *v.* Cowdrey, 11 Wall. 459; who are not: Garrard *v.* P. & C. R. Co., 29 Pa. St. 154; Am. L. & T. Co. *v.* St. L. & C. R. Co., 42 Fed. Rep. 819; Smith *v.* Fla., C. & W. R. Co., 43 Fed. Rep. 741.

[4] Schutte *v.* Florida Cent. R. Co. (1879), 3 Woods, 692. See also Butler *v.* Rahm (1877), 46 Md. 541; s. c. 18 Am. Ry. Rep. 86.

[5] Claflin *v.* South Carolina R. Co. (1880), 8 Fed. Rep. 118, per Waite, C. J.

[6] Hodder *v.* Kentucky & Great East. R. Co. (1881), 7 Fed. Rep. 793.

As between the bondholders and persons acquiring liens on the mortgaged property subsequent to the recording of the mortgage, the rights of *bona fide* holders of bonds are to be determined as if they were acquired at the date of the recording of the mortgage.[1]

§ 54. **Bondholders are entitled to assume that Statement in Bonds as to Date of Issue is correct.** — Purchasers of bonds issued under a mortgage purporting to be of even date with the bonds are not put on their inquiry as to whether the bonds and mortgage were, in fact, issued simultaneously, or whether in the meantime liens of material-men have attached.[2]

§ 55. **Bona Fide Holders of Bonds not protected, if Issue was ultra vires.** — Persons dealing with the negotiable securities of a corporation are chargeable with knowledge of the extent of the power to make them, as conferred by the charter or the general statute by virtue of which the incorporation was effected. This principle is elementary, and its existence is assumed in all the statements of the rights of *bona fide* holders of bonds irregularly issued. The most difficult cases are those in which it becomes necessary to determine whether the legislative direction which the company has failed to observe is in the nature of a mandatory condition precedent, or of a merely directory formality. In regard to corporate securities, the New Jersey Court of Appeals has formulated a general rule on the following terms: "If the power granted by the charter is subject to a condition relating either to the form in which the security shall be made in order to be valid, or to some preliminary proceeding extraneous to the acts of the corporation or its officers, securities not in the prescribed form, or issued without the preliminary proceedings had, are subject to defences in consequence thereof even in the hands of *bona fide* holders.[3]

Where bonds are shown to have been illegally issued, the burden is thrown on the holder of showing that he paid value for them, and had no notice of their illegality; and bonds issued in violation of a statute limiting the issue to the amount of stock actually paid in at the time are void as between the parties to the transaction.[4]

The defect of power will, it seems, be more fatal in proportion as the contract is of a usual or unusual character. Thus, on the ground that a contract of guaranty is outside the ordinary busi-

[1] Belden *v.* Burke (1894), 72 Hun, 51.

[2] Neilson *v.* Iowa Eastern Ry. Co. (Iowa, 1875), 8 Am. Ry. Rep. 82.

[3] Hackensack Water Co. *v.* DeKay (1883), 36 N. J. Eq. 548.

[4] Baker *v.* Guarantee Trust Co. (N. J. Eq. 1895), 31 Atl. Rep. 174, citing State *v.* Board of Chosen Freeholders (1877), 39 N. J. L. 632; Crampton *v.* Zabriskie (1879), 101 U. S. 601; Atlantic City Waterworks Co. *v.* Read (1888), 50 N. J. L. 665; s. c. 15 Atl. Rep. 10.

ness of a railroad company, it has been held that the purchaser of bonds of one company guarantied by another is bound to inquire into the corporate powers of the guarantor company. In other words, the commercial character of the bond and guaranty do not relieve a purchaser from the risk of the want of corporate authority to execute the bonds; and although a purchaser for value and without actual notice of the want of authority, he will not be accorded the rights of an innocent purchaser as regards the obligation of the guaranty.[1]

§ 56. **Bona Fide Holders of Corporate Bonds protected if Issue was merely irregular.** — In the courts of this country and of England the law is settled that, where the corporation has power under any circumstances to issue negotiable securities, a *bona fide* holder has a right to presume that they were issued under the circumstances which give the requisite authority.[2]

The distinction is between limitations and conditions in the statute from which the corporation derives its powers — external matters of which the public had notice by the public record — and acts to be done by the corporation or its officers, as conditions precedent to the making of such securities, in the internal affairs of the company.[3]

The most common example of the rule that a *bona fide* holder is not obliged to take notice of the "indoor management of the company" is found in that class of cases where certain formalities in the making of corporate contracts are prescribed for the security of the stockholders. It is well settled that the non-observance

[1] Louisville, etc. R. Co. *v.* Ohio Valley Improvement, etc. Co. (1894), 69 Fed. Rep. 431. The Indiana statute, under which this case was decided, provided that the directors of a railroad company might, upon the petition of the holders of a majority of the stock of the company, direct the execution of a guaranty of the bonds of another company. The guaranty held to be invalid was executed without any such petition, and promptly disavowed by the stockholders.

[2] Hackensack Water Co. *v.* DeKay (1883), 36 N. J. Eq. 548, citing a large number of cases. In that case a company was authorized to issue bonds to an amount not exceeding two-thirds of its paid-up capital. The directors violated their duty by issuing bonds of an amount within the limits allowed, but before the capital was subscribed and paid up to the extent demanded by the charter. The bonds were secured by a mortgage, executed with all due formalities, and having on its face every appearance of having been made in strict pursuance of the power of the company. It was held that, as against a *bona fide* holder of these bonds, who had taken them upon the faith that the mortgage was what it appeared to be, the company could not defend on the ground of imperfections due solely to the omission of acts which the directors should have done in the management of the private business of the company.

[3] Hackensack Water Co. *v.* DeKay (1883), 36 N. J. Eq. 548; S. P. Baker *v.* Guarantee T. Co. (N. J. Eq. 1895), 31 Atl. Rep. 174.

of these formalities in issuing bonds will not invalidate them in the hands of a *bona fide* holder.[1]

Another application of the general principle is that the fact of a bond having been issued for a purpose not authorized by the company's charter will not prevent a *bona fide* holder from recovering thereon, provided there is nothing on the face of the instrument to show that it has not been duly issued in conformity with the provisions of the charter.[2]

Thus, where the doctrine is held that it is within the corporate power of a railroad company to sell and guaranty bonds held in the usual course of business,[3] a *bona fide* holder may hold the company on such a guaranty, though it was given for the purpose of enabling the obligor company to raise money for the construction of a road, and such construction was foreign to the objects for which the guarantor company was incorporated.[4]

[1] Mahoney *v.* East Holyford Mining Co., L. R. 7 H. L. 893, where Lord Hatherley drew a distinction between acts done in reference to the indoor management of the company, and acts which must be sustained, if at all, by a consideration of the contents of the enabling statute and the articles of association. In another case the same eminent judge remarked that if the party contracting with the directors finds the acts to be within the scope of their power under the deed of settlement, he has a right to assume that all conditions precedent to its exercise have been complied with. *In re* Athenæum Society, 4 K. & J. 549.

In the registered deed of settlement of a joint-stock company the directors were authorized to borrow on bonds such sums as should from time to time be authorized by a general resolution of the company. A bond, sealed with the common seal, was given by the directors to a banker, without a resolution of the company authorizing it. It was adjudged that, under the circumstances, the obligee had a right to presume that there had been a resolution at a general meeting, as the deed of settlement prescribed. Chief Justice Jervis, in delivering the opinion of the Court of Exchequer Chamber, said: "The party here, on reading the deed of settlement, would find, not a prohibition from borrowing, but a permission to do so on certain conditions. Finding the authority might be made complete by a resolution, he would have the right to infer the fact of a resolution, authorizing that which on the face of the document appeared to be legitimately done." Royal British Bank *v.* Turquand, 6 El. & Bl. 327.

"A citizen who deals directly with a corporation, or who takes its negotiable paper, is presumed to know the extent of its corporate power. But when the paper is, upon its face, in all respects such as the corporation has authority to issue, and its only defect consists in some extrinsic fact, such as the purpose or object for which it was issued, to hold that the person taking the paper must inquire as to such extraneous fact, of the existence of which he is in no way apprised, would obviously conflict with the whole policy of the law in regard to negotiable paper." Farmers' & Mechanics' Bank *v.* The Butchers' & Drovers' Bank, 16 N. Y. 125.

Bonds cannot be invalidated in the hands of *bona fide* holders by the fact that they were not submitted by the directors to the vote of the stockholders. Phinizy *v.* Augusta, etc. R. Co. (1894), 62 Fed. Rep. 678.

[2] Rule as to all kinds of negotiable securities of corporation so stated by Walworth, Ch., in Stoney *v.* American L. Ins. Co. (1845), 11 Paige Ch. 635.

[3] Some courts deny this. See next section and Chapter IV.

[4] Madison, etc. R. Co. *v.* Norwich Sav. Soc. (1865), 24 Ind. 457.

The operation of the same principle is also seen in those cases which lay down the rule that, as a railroad company has a general power to make contracts and borrow money, persons dealing in securities issued by it may, in the absence of notice to the contrary, assume that restrictions upon this power, for example, in regard to the price at which bonds may be sold, have not been violated.[1]

The reasons for applying the principle are of course much stronger where the bonds expressly recite that they were issued in accordance with the enabling statute. Such a recital is usually found in debentures issued by English joint-stock companies. As to these, the rule is now axiomatic that, where they purport to have been issued pursuant to powers conferred by statute, the company is estopped from alleging against innocent assignees for value that the debentures were issued illegally, and in contravention of the corporate powers.[2]

In this country an express recital of this kind in the bonds themselves is not very common. But it has been held in a New Jersey case that purchasers of bonds which profess to have been issued in accordance with a law limiting the amount of the issue to the amount of the capital paid in have a right to rely on the statement so made. Whether there has been a violation of such a law necessarily depends upon facts within the knowledge of the corporate officers only.[3]

A similar rule has been applied in the case of State-indorsed bonds, in regard to which it has been held that where the statute authorizing the indorsement refers to them as first-mortgage bonds, *bona fide* holders have a right to presume that all precedent requirements had been complied with, and that there were no prior liens upon the railroad. So far as they were concerned

[1] Ellsworth's Admrs. *v.* St. Louis, Terre Haute, & Alton R. Co. (1885), 98 N. Y. 553.

[2] Webb *v.* Commissioners, L. R. 5 Q. B. 642. Other expositions of this principle will be found in Agar *v.* Life Assn. Co., 3 C. B. N. S. 725; Prince of Wales Assn. Co. *v.* Harding, El., Bl. & El. 183; *In re* Land Credit Co., L. R. 4. Ch. App. 460; *In re* Gen. Prov. Assn. Co., L. R. 14 Eq. 507; *In re* Gen. South Amer. Co., L. R. 2 Ch. Div. 337; *In re* Int. Pulp Co. L. R. 6 Ch. Div. 556.

[3] Baker *v.* Guarantee Trust Co. (N. J. Eq. 1895), 31 Atl. 174. See also on effect of recitals in this section, below. The same principle has frequently been applied in cases relating to municipal bonds.

The general rule is that where bonds import a compliance with the law under which they are issued, *bona fide* purchasers are not bound to look further for evidence of a compliance with the conditions of the grant of power. Commissioners *v.* Aspinwall, 21 How. 539. The only matters open to inquiry are the *bona fides* of the purchase, and the statutory authority to issue the bonds. Rouede *v.* Mayor, etc. of Jersey City (1883), 18 Fed. Rep. 719. As to what will put a purchaser upon inquiry, see Riggs *v.* Penn. & New Engl. R. Co., 16 Fed. Rep. 804.

in the case cited below, it was held that this presumption could not be rebutted.[1]

Where railroad bonds are valid on their face, the burden is not upon the holder to show that the provisions of law authorizing their issue have been complied with, but upon the party claiming them to be invalid to show their invalidity.[2]

But a Purchaser with Notice of Circumstances qualifying his Rights is not protected as a Bona Fide Purchaser. — The doctrine which validates securities within the apparent powers of the corporation, but improperly and therefore illegally issued, applies only in favor of *bona fide* holders for value. A person who takes such a security with knowledge that the conditions on which alone the security was authorized were not fulfilled is not protected, and in his hands the security is invalid, though the imperfection is in some matter relating to the internal affairs of the corporation, which would be unavailable against a *bona fide* holder of the same security.[3]

The special relations of the purchasers to the company and to each other will occasionally justify a court in denying them the rights of *bona fide* holders.[4]

The recitals of the bonds may sometimes be such as to operate as implied notice of circumstances qualifying the purchasers' rights. Thus they are put upon inquiry as to the validity of the

[1] Young *v.* Montgomery & Eufaula R. Co. (1875), 2 Woods, 606, where such holders were held to be entitled to be subrogated to the rights of the State in the security taken as indemnity for its indorsement of the company's bonds.

[2] Nichols *v.* Mase (1883), 94 N. Y. 160; s. c. 17 Am. & Eng. R. R. Cas. 230, affirming Nichols *v.* Mase (1881), 25 Hun, 640. See also Heinsheimer *v.* Dayton R. Co. (1888), 3 Ry. & Corp. L. J. 268.

[3] Hackensack Water Co. *v.* DeKay (1883), 36 N. J. Eq. 548, citing *In re* Magdalena Steam Nav. Co., 6 Jur. N. S. 975; Woodhams *v.* Anglo-Australian Co., 8 Jur. N. S. 148; *In re* South Essex Gas Light Co., 8 Jur. N. S. 357; *In re* Patent Bread Machine Co., 7 Ch. App. 289; *In re* Gen. Provident Ass. Co., L. R. 14 Eq. 507; *In re* Hercules Ins. Co., L. R. 19 Eq. 302, 310; *In re* International Pulp Co., L. R. 6 Ch. Div. 556, 560; *In re* Native Iron Ore Co., L. R. 2 Ch. Div. 345; *In re* S. Amer. Co., L. R. 2 Ch. Div. 337.

[4] Silliman *v.* Fredericksburg, etc. R. Co. (1876), 27 Gratt. 119; 17 Am. Ry. Rep. 157. There a part of the bonds were held by the president of the company, another part jointly by the president and A., another part jointly by A. and a certain bank. Under such a showing it was held that they must be held to have taken their bonds with knowledge of the State's right to forfeit the property and franchises of the company if the road was not completed at a specified date.

In Chambers *v.* M. & M. Ry. Co., 5 B. & S. 588, a railway company was empowered by its special act to raise a sum in addition to its original capital, but not until the whole of the capital had been subscribed for and one-half paid up. The court held that no action could be sustained on a bond held by the chairman of the company, who had knowledge of the purpose for which the bond was executed and was a party to the resolutions by which the secretary was authorized to seal them.

issue of bonds, where they declare that they are to be payable at the place which shall be determined by the president's indorsement, and that the sum payable shall depend on that indorsement, and yet no indorsement appears upon them. Especially will it be impossible for the purchasers of such bonds to claim the rights of *bona fide* purchasers, if the price at which they were offered for sale was a suspiciously small one, and there are several years of unpaid coupons still attached to them.[1]

(As to imputed notice of statutory provisions which render an issue of bonds *ultra vires*, see *ante*.)

The purchaser of bonds expressly reciting that they are for the principal and interest of other bonds which are held as collateral security, is chargeable with notice of the fact that the indebtedness secured was overdue, and he is thereby subject to all infirmities attaching to it, although the date of payment named in the original bonds held as collateral was later than the time of the purchase.[2]

§ 57. **Rights of Holders where there is an Over-issue.** — Where a corporation agrees that the amount of bonds issued shall be limited to a fixed number per mile, whoever purchases any of the bonds upon the faith of such contract is as much entitled to the benefit of such a contract as though it had been made with him, and bonds issued in excess are to be postponed in payment to those within the limit.[3]

Where a mortgage of property is made to secure bonds of certain descriptions, not exceeding a certain sum in the aggregate, and recites other bonded indebtedness covered by prior

[1] Parsons *v.* Jackson (1878), 99 U. S. 434.

[2] Higgins *v.* Lansingh (1895), 154 Ill. 301; s. c. 40 N. E. Rep. 362.

[3] Union Trust Co. *v.* Nevada & O. R. Co. (1884), 20 Fed. Rep. 80, modified in McMurray *v.* Moran (1889), 134 U. S. 159.

In this last case the company had contracted to build a portion of its road, and agreed that the contract should be paid partly in bonds to the amount of a fixed sum per mile of the road, and that this was to be the limit of bonds issued upon that part of the line. Afterwards the company settled with the contractor, and made an agreement by which it could draw money due as a balance on certain of these bonds in the hands of a purchaser from the contractor; and in this and all other negotiations subsequent to the original agreement with the contractor as to the limitation upon the issue of these bonds, recognized such agreement. The court said, in giving judgment in favor of such bondholders' lien, in preference to that claimed by persons to whom, for various debts due to them, the company had paid bonds which were, in view of this agreement, an over-issue: "The limitation upon the issue of first-mortgage bonds is the sole condition which gave the bonds value and made it possible to negotiate them, and whoever purchased any of these first-mortgage bonds upon the faith of this railroad company, as pledged in these contracts with Moore, limiting the amount of issue, is as much entitled to the benefit of those contracts in this respect as though they had been made with the purchaser himself."

liens, and that the new bonds were to be substituted for the old, the lien of the new mortgage is confined to an amount which, added to the prior specified incumbrances, shall not exceed the limit fixed. But this is the sole restriction implied by the contract. Subsequent incumbrancers will not be permitted to assert a priority as against the holders of that portion of the issue which is not needed for the purpose of paying off the old bonds. Such surplus bonds will take precedence in the hands of *bona fide* holders, whether sold before or after the execution of the junior mortgage.[1]

In a controversy between bondholders, part of whom claimed that certain bonds of higher numbers were an over-issue, and therefore not entitled to any payment from the proceeds of the road on account of issue being limited to $16,000 per mile, it was held by the court that, since the holders of bonds issued in excess of this amount had purchased them in good faith and after ascertaining that the Governor had indorsed them, and, as the law authorizing their issue required, had recited in his indorsement that he had done so in pursuance of law, and all the statements on bonds and mortgages which put the purchasers on inquiry lulled and satisfied inquiry, they were not bound to look any further. These bonds of the higher numbers, or excessive issue, if it were such, were therefore entitled to share *pro rata* with the others. The purchasers were entitled to presume that, as the bonds bore the indorsement of the State, the Governor had not violated his duty, and that there was evidence on file to the effect that a sufficient number of miles had been constructed to authorize him to indorse the bonds.[2]

[1] Claflin *v.* South Carolina R. Co. (1880), 8 Fed. Rep. 118, 122.

In this case a first mortgage was executed to secure an issue of bonds to a stated amount by a railroad company. The bonds were to be used in substitution for bonds of a former issue, and any not used in that way were to be left in the hands of the company, to be used as they should see proper. A holder of bonds under a second mortgage, which recognized the first mortgage as a lien to the extent of the amount of bonds authorized upon it, maintained that bonds of the first issue, used by the company as pledges and otherwise to secure loans to the company, were bonds issued contrary to the limitations of the mortgage, and should not be preferred to these bonds. Waite, C. J., ruled against this contention, and said: "The second mortgagee voluntarily permitted the first mortgage to stand as it was. In this the second mortgage bondholders are represented and bound by their trustees. Whatever the company could do with the first bonds before, it might do after, so far as any express limitations in the second mortgage were concerned. The lien of the first mortgage to its full amount was recognized, and nothing was said or done having directly any intention to limit the power of the company under it."

[2] Stanton *et al.* Trustees *v.* Alabama & Chattanooga R. Co. (1875), 2 Woods, 523. See also State *ex rel.* Plock & Co. *v.* Cobb (1879), 64 Ala. 127; 7 Am. & Eng. R. R. Cas. 147.

In a case in Kentucky, where a mortgage was made for $400,000, to insure four hundred bonds, twenty extra bonds were issued by mistake and were purchased *bona fide*. There was a certificate to each of these bonds that it was secured by mortgage, and that the amount of such bonds issued and to be issued was not to exceed $400,000. The bonds were not numbered consecutively, but in two classes, for which reason holders could not detect the over-issue by examination of the mortgage, as the latter did not describe the manner in which the bonds were numbered. As to the company, it was held to be estopped to deny that the twenty extra bonds were secured by the mortgage, and that by this estoppel the mortgagor gave the holder of them an equitable lien, which, though unrecorded, was superior to the lien given by unrecorded income-bonds subsequently issued, but inferior to that given by a subsequently recorded mortgage. Further, that where the purchaser of the third-mortgage bonds had no notice of the over-issue, but had notice of the income bonds, the holder of the latter would be substituted to the legal advantage which the purchaser acquired by the record of the third mortgage, and was consequently entitled to a preference over the holders of the extra bonds.[1]

The Massachusetts statute of 1854, ch. 286, limited the issue of the bonds to the amount of capital actually paid in. A company having issued largely in excess of that amount, the court held that the illegality of those bonds was apparent on their face, and open equally to the knowledge of the party who issued and the party who received them, and that, though the company did not seek to repudiate them, one who had taken a valid second mortgage containing no contracts of warranty, but not made expressly subject to the former mortgage, might take advantage of their invalidity.[2]

§ 58. **Rights of Bona Fide Holders not affected by Misapplication of Proceeds of Bonds by Original Holders or others.** — The misappropriation of the proceeds of a sale of bonds cannot affect a purchaser[3] unless he has notice of such misapplication.[4]

[1] Stephens *v.* Benton (1863), 1 Duv. (Ky.) 112.

[2] Comm. *v.* Smith (1865), 10 Allen, 448. The provision here construed is incorporated in the Mass. Pub. Stat. of 1882, ch. 112, § 62. See Peatman *v.* Centerville Light, Heat, & Power Co. (Iowa), 69 N. W. Rep. 541, holding the bonds issued in excess to be valid to the extent of the consideration received for them.

[3] Peoria & S. R. Co. *v.* Thompson (1882), 103 Ill. 187; s. c. 7 Am. & Eng. R. R. Cas. 101; Stradley *v.* Pailthorp (1893), 96 Mich. 287; s. c. 55 N. W. Rep. 807; Thompson *et al.* *v.* Lambert *et al.* (1876), 44 Iowa, 239; Morton *v.* New Orleans & Selma Ry. Co. (1885), 79 Ala. 590. See also Haley *v.* Halifax St. Ry. Co., 25 Nova Scotia L. R. 140.

[4] Morton *v.* New Orleans & Selma Ry. Co. (1885), 79 Ala. 590.

Bona fide purchasers of bonds are not affected in their rights by the fact that the original holders, who were the president and vice-president of the company, consented to the misappropriation of the proceeds.[1]

Such a purchaser is not bound to see to the application of the money to the purposes of the corporation.[2]

"The duty of the company to pay the bonds, and the duty of the chancellor to subject to their payment the security pledged for that purpose, cannot be called in question because of the subsequent default of the company in the performance of a public duty." [3]

That bonds were issued and exchanged for State bonds in order that the stockholders of the company might use the proceeds of the State bonds for their own private advantage, and that they were so used contrary to the statute authorizing the exchange, is no defence against the bonds of the company in the hands of a *bona fide* holder.[4]

§ 59. **No Recovery on Bonds where the Trustee's Certificate is a Forgery.** — Wherever a part of the bonds, upon the genuineness of which the obligatory effect of the bonds depends, is a forgery, the general principle is applicable, that no liability can be predicated upon a forged negotiable instrument, even if the holder is an innocent purchaser. Thus where each bond provides on its face that it "shall not become obligatory until it shall have been authenticated by a certificate indorsed thereon, duly signed by the trustee," a purchaser must at his peril ascertain whether the certificate is genuine. If he takes a bond relying on the assurance of his vendor that it is genuine, and the signature of the trustee proves to be a forgery, the fact that he paid value and bought in good faith cannot relieve him from the consequences of his omission to make proper inquiries.[5]

§ 60. **Amount recoverable on Bonds where they have been purchased at less than the Face Value.** — In a late case in the Supreme Court of the United States the rule as to the amount which a holder of bonds is entitled to recover was stated as follows: "By the decisive weight of authority in this country, where negotiable paper has been put in circulation, and there is no infirmity or defence between the antecedent parties thereto, a purchaser of such

[1] Belden *v.* Burke (1894), 72 Hun, 51.

[2] Philadelphia & Sunbury R. Co. *v.* Lewis (1859), 33 Pa. St. 33.

[3] Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush (Ky.), 673.

[4] Schutte *v.* Florida Cent. R. Co. (1879), 3 Woods, 692.

[5] Maas *v.* Missouri, Kansas, & Texas Ry. Co. (1880), 83 N. Y. 223. As to liability of trustee to bondholder upon a certificate on bond that it is secured by a mortgage which in fact was never executed, see Miles *v.* Roberts (1896), 76 Fed. Rep. 919.

securities is entitled to recover thereon, as against the maker, the whole amount, irrespective of what he may have paid therefor.[1]

This rule avails in favor of a purchaser from one who has bought at a pledgee's sale.[2]

As to whether one who holds bonds as collateral security for a debt smaller in amount than the face of the bonds should be allowed to recover the whole amount due thereon, the courts are at variance. The generally received doctrine is believed to be that the pledgee should recover the full amount due on the instruments, though in excess of the debt secured thereby.

§ 61. **Title of Bona Fide Purchaser not affected by Fraud of Person intrusted with the Negotiation of the Bonds.** — The entire absence of delivery of negotiable instruments has, in a majority of cases, been regarded as a sufficient defence even against an innocent holder, unless the maker has executed an instrument perfect in form, and been negligent in letting it go out of his possession.[3] But when a corporation has made its negotiable bonds perfect in form, payable to bearer, and has caused them to be certified by the trustee, as evidence that they have become obligatory, and has placed them in possession of its president, with authority to exchange them for the benefit of the company alone, the company cannot defeat the title of an innocent purchaser for value and before maturity by showing that its president has fraudulently pledged or sold such negotiable bonds for his own private use, with its knowledge or consent.[4]

§ 62. **Purchase of Bonds by Directors of a Company at a Discount.** — Upon the question whether a director may purchase the bonds of his own company at a discount, the authorities are in

[1] Wade *v.* Chicago, Springfield, & St. Louis R. Co. (1894), 149 U. S. 327, citing Cromwell *v.* Sac County (1877), 96 U. S. 51; Fowler *v.* Strickland (1871), 107 Mass. 552; Moore *v.* Baird (1858), 30 Pa. St. 138; Bange *v.* Flint (1876), 25 Wis. 544; Nat. Bank of Mich. *v.* Green (1871), 33 Iowa, 140; Baily *v.* Smith (1863), 14 Ohio St. 396.

[2] Morris Canal, etc. Co. *v.* Lewis (1858), 12 N. J. Eq. 323; Wade *v.* Chicago, Springfield, & St. L. R. Co. (1894), 149 U. S. 327. In Grand Rapids, etc. R. Co. *v.* Sanders (1877), 54 How. Pr. 214, the court restricted the recovery of one who bought from a transferee of the pledgee to the amount actually paid to such transferee. The bonds were apparently acquired in the ordinary course of business, and not at a sale upon the pledgor's default in the payment of his debt, as in the cases cited in § 56, *ante.* But it is not quite apparent why the original and the second transferees, if, as the court declared, they were both in the position of *bona fide* purchasers, should not both have been entitled to recover the face value of the bonds. Admitting that the transfer by the pledgee was wrongful, the transferees were surely in at least as strong a position as one who acquires lost or stolen commercial paper payable to bearer.

[3] Long Island Loan & Trust Co. *v.* Columbus, C. & I. C. Ry. Co. (1895), 65 Fed. Rep. 455.

[4] Ibid.

conflict. In New York it is held that a director cannot purchase such bonds below par except on peril of the avoidance of the transaction by the courts on the application of the corporation, but he is entitled in a foreclosure suit to prove as many bonds as he may hold as pledgee, and share in the distribution up to the amount of the debt secured by the pledge.[1]

By a subsequent decision, however, the application of this rule would seem to be confined to cases where the director is dealing directly with the company, and not to cases where he is dealing wholly with third persons to whom he owes no duty.[2]

In Illinois it has been quite recently ruled that a director may purchase claims against his corporation at a discount and enforce them in full, provided he acts fairly and for the interest of the corporation, and the corporation is given a fair opportunity to become the purchaser itself, and cannot or will not embrace the opportunity.[3]

Such is apparently the rule in Kansas also.[4]

§ 63. **Amount recoverable on Bonds tainted with Fraud in their Issue.** — Bonds given by a company in pursuance of a construction contract fraudulent and void, on account of its being made with another company in which the directors of the obligor corporation are interested, are themselves void, and cannot be enforced unless they have passed into the hands of innocent holders for value. But a holder who does not receive them in the ordinary course of business may recover upon them to the extent of the value of the work actually done by the construction company, such value to be estimated as on a *quantum meruit* without regard to the prices fixed by the contract.[5]

§ 64. **Innocent Purchaser of Stolen Bonds entitled to recover thereon.** — A purchaser of negotiable bonds before maturity, in the usual course of business, acquires a good title thereto, although

1 Duncomb *v.* New York, etc. R. Co. (1881), 84 N. Y. 190; s. c. 4 Am. & Eng. R. R. Cas. 293.

2 Inglehart *v.* Thousand Islands Hotel Co. (1888), 109 N. Y. 454, where the president of the company was allowed to make a profit out of a judgment against it.

3 Higgins *v.* Lansingh (1895), 154 Ill. 300, 386; s. c. 40 N. E. Rep. 362. The court, however, thought the case a proper one for denying this privilege to the director, as at the time of the purchase he practically controlled the corporation, and the other members of the board knew nothing about the intended sale of the securities.

4 St. Louis, Fort Scott, & Wichita R. Co. *v.* Chenault *et al.* (1886), 36 Kan. 51, 57.

5 Thomas *v.* Brownville, Fort Kearney, & Pac. R. Co. (1883), 109 U. S. 522, approving Wardell *v.* Railroad Co. (1877), 4 Dill. 330, 339; Wardell *v.* Railroad Co. (1880), 103 U. S. 651, 659, where the plaintiff was allowed to recover a fair compensation for his personal services under a contract in itself fraudulent.

they may have been stolen; and in a suit by the purchaser the burden of proof that he did not acquire them in good faith is upon the defendant.[1]

§ 65. **Rights of Purchaser of Bonds the Coupons of which are overdue.** — A purchaser of negotiable bonds in good faith and for their full market value does not lose his rights as a *bona fide* holder merely by reason of the fact that some of the interest coupons attached thereto are past due and unpaid at the time of the purchase.[2]

A few cases countenance the doctrine that this fact is sufficiently suspicious to put the purchaser on inquiry, and to impair his title to that extent; but these are opposed to the general current of authority.[3]

[1] Murray *v.* Lardner (1864), 2 Wall. 110, containing a review of the previous authorities in this country and in England; same principle, Hotchkiss *v.* National Banks (1874), 21 Wall. 354; Consolidated Association, etc. *v.* Avegno (1876), 28 La. Ann. 552; Dutchess Co. Insurance Co. *v.* Hachfield (1874), 1 Hun, 675; Venables *v.* Baring Bros. (1892), L. R. 3 Ch. 527. Compare Seybel *v.* National Currency Bank (1873), 54 N. Y. 288, a case where United States bonds had been stolen, and State of California *v.* Wells, Fargo, & Co. (1860), 15 Cal. 336, where the instruments were warrants of State indebtedness.

In Ledwich *v.* McKim (1873), 53 N. Y. 307, incomplete bonds, stolen from the office of a Southern railroad company by Federal soldiers during the war, and sold in New York, were held not to be good against the company even in the hands of *bona fide* purchasers. This ruling was based upon the principle that the rule that the *bona fide* holder of an incomplete instrument, negotiable but for some omission capable of being supplied, has an implied authority to supply the omission and to hold the maker thereon, only applies where the latter has, by his own act or the act of another, authorized, confided in, or invited with apparent authority by him, put the instrument in circulation as negotiable. See also Jackson *v.* Vicksburg, Shreveport, & Texas R. Co. (1875), 2 Woods, 141.

In Maas *v.* Missouri, K. & T. R. Co. (1880), 83 N. Y. 223, affirming Same *v.* Same (1877), 11 Hun, 8, it was held that neither the payment of value nor good faith on the part of the purchasers of bonds which had been stolen, and a seal and certificate forged thereon to apparently complete them, created a cause of action; nor did the failure of the obligor, after discovering that the bonds had been lost or stolen, to notify the public of that fact constitute negligence that would make it liable.

[2] Cromwell *v.* County of Sac (1877), 96 U. S. 51; Morgan *v.* United States (1885), 113 U. S. 476; Railroad Co. *v.* Sprague (1880), 103 U. S. 756; Thompson *v.* Perrine (1882), 106 U. S. 589; McLane *v.* Placerville & Sacramento Valley R. Co. (1885), 66 Cal. 606; National Bank, etc. *v.* Kirby (1871), 108 Mass. 497; State *ex rel.* Plock & Co. *v.* Cobb (1879), 64 Ala. 127; s. c. 7 Am. & Eng. R. R. Cas. 147; Boss *v.* Hewitt (1862), 15 Wis. 260; Long Island Loan & Trust Co. *v.* Columbus, C. & I. C. Ry. Co. (1895), 65 Fed. Rep. 455.

[3] First National Bank, etc. *v.* Commissioners (1869), 14 Minn. 77; Morton *v.* New Orleans & Selma R. Co. (1885), 79 Ala. 590; Parsons *v.* Jackson (1878), 99 U. S. 434. In the last case, however, the fact of overdue coupons being still attached to the bonds was only one of several circumstances of suspicion, and it is scarcely an authority for the naked proposition that, as a matter of law, the purchaser is put upon inquiry by this one circumstance alone. Indeed, to put this construction on the decision would render it quite irreconcilable with the other rul-

§ 66. **Pledgees of Bonds as Bona Fide Holders.** — Whether a pledgee of bonds is to be regarded as a *bona fide* holder must be determined by the principles accepted on this subject in the jurisdiction where the question arises, and as to some of those principles there is, as is well known, an irreconcilable difference of opinion between the courts of this country.

The weight of authority is in favor of the view that a pledge of bonds for an antecedent debt secures to the pledgee the rights of a *bona fide* holder, as long as the debt for which they were hypothecated remains unpaid, provided the other elements of an innocent transfer are present.[1]

Thus one who in good faith advances money upon a sham note secured by a pledge of bonds is a *bona fide* holder of such bonds, where he has no knowledge of fraud in their issuance.[2]

But this doctrine has been repudiated in several States, among others in Alabama, where it has been held that taking bonds as collateral security for an antecedent debt is not a purchase for value, even when forbearance or indulgence is granted, a distinction being taken between the acquisition of bonds in this manner and receiving them in payment of a pre-existing debt.[3]

A like rule prevails in New York.[4]

§ 67. **Rights of Purchasers of Pledged Bonds.** — The ordinary rule is that a pledge of commercial paper does not carry the power to sell or dispose of it.

ings of the same court cited in the last note, especially Cromwell *v.* County of Sac, as well as with the general doctrine now accepted in respect to negotiable instruments, that suspicion of defect of title, or the knowledge of circumstances that would excite suspicion in the mind of a prudent man, or even gross negligence on the buyer's part, will not affect his title. Nothing short of bad faith on the part of the purchaser of commercial paper passing by delivery, and fair upon its face, will destroy its validity, and the burden of proof lies on the person who assails the title of the party in possession. See Murray *v.* Lardner (1864), 2 Wall. 110; Phil. & Sunbury R. Co. *v.* Lewis (1859), 33 Pa. St. 33; Galveston Railroad *v.* Cowdrey (1870), 11 Wall. 459; Spence *v.* Mobile & Montgomery R. Co. (1885), 79 Ala. 576; Goodman *v.* Simonds (1857), 20 How. 343; Goodman *v.* Harvey, 4 Ad. & El. 870; Long Island Loan & Trust Co. *v.* Columbus, C. & I. C. Ry. Co. (1895), 65 Fed. Rep. 455.

[1] Allen *v.* Dallas & Wichita R. Co. (1878), 3 Woods, 316; Baker *v.* Guarantee T. Co. (N. J. Eq., 1895), 31 Atl. Rep. 174; Allaire *v.* Hartshorne (1847), 21 N. J. L. 665; Hayden, Trustee, *v.* Lincoln City Electric, etc. Ry. Co. (1895), 43 Neb. 630; s. c. 62 N. W. Rep. 73. See also Porter *v.* Pittsburg Bessemer Steel Co. (1887), 120 U. S. 649, holding the pledgees of railroad bonds for advances of money already made and to be made to be used in the construction of the railroad to be *bona fide* holders and entitled to priority in the distribution of sale under foreclosure of mortgage.

[2] Thomson-Houston Electric Co. *v.* Capitol Electric Co. (1894), 65 Fed. Rep. 341; s. c. 12 C. C. A. 643.

[3] Reid *v.* Bank of Mobile (1883), 70 Ala. 199; 14 Am. & Eng. R. R. Cas. 554.

[4] Duncomb *v.* New York, etc. R. Co. (1881), 84 N. Y. 190; s. c. 4 Am. & Eng. R. R. Cas. 293.

In Illinois this rule has been applied to a sale of railroad bonds.[1]

But by most of the courts in which the subject has been discussed the bonds of corporations have been excepted from the operation of the rule. Thus in New Jersey it has been held that when a corporation which has pledged its bonds as collateral for a loan upon a note, and at its maturity failed to pay the note, the pledgee is not bound to sue the corporation upon the note, but can, as usual with pledges, on his own motion, and with proper notice, sell the bonds pledged, and the purchaser at such sale acquires the whole interest in the bonds, and can enforce them against the corporation for their full amount. Such a deposit, it was said, differs entirely from a deposit of ordinary bonds, mortgages, promissory notes, and like *choses in action*, which, in the absence of an agreement to that effect, the creditor cannot expose to sale, because they have no market value, and it cannot be presumed that it was the intention of the parties thus to deal with them.[2]

In New York also the rule is that pledged railroad bonds may be sold at public auction, after the debt is due, upon a demand of payment and due notice of the time and place of sale, unless a sale is restricted by positive stipulation.[3]

The Supreme Court of the United States has taken the same view, declaring a contention that the pledgee could not sell pledged bonds after the company had been adjudicated bankrupt to be quite untenable. The ground taken was, the bonds were negotiable instruments, passing by delivery, and that, even where there is no expressed stipulation in contracts of pledge, to the effect that the pledgee may sell on default of the pledgor, such a right is presumable from the nature of the transaction.[4]

Where bonds are purchased in proceedings to foreclose the lien of the pledgee, the purchaser is entitled to have his rights as an owner for value enforced;[5] and the fact that, at the foreclosure,

[1] Joliet Iron & Steel Co. *v.* Scioto Fire & Brick Co. (1876), 82 Ill. 548.

[2] Morris Canal & Bkg. Co. *v.* Lewis (1858), 12 N. J. Eq. 323. See also Morris Canal & Bkg. Co. *v.* Fisher (1855), 9 N. J. Eq. 667.

[3] Brown *v.* Ward (1854), 3 Duer, 660, also distinguishing railroad bonds from other commercial paper. In Grand Rapids, etc. R. Co. *v.* Sanders (1877), 54 How. Pr. 214, the power of the pledgee to sell railroad bonds was assumed in the argument; but the above case was not referred to, nor was anything said in regard to the general rule and the exception in the case of bonds.

[4] Jerome *v.* McCarter (1876), 94 U. S. 734.

[5] Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush, 673; s. c. 18 Am. Ry. Rep. 221.

the bonds brought a very small price will not affect the purchaser's title, unless some fraud is shown.[1]

In a bill for redemption it was held that bonds given as collateral security only, and taken by the holder with notice, should be treated as valid only to the extent of the debt due,[2] the balance being in such case held by him in trust for the pledgor. Other authorities limit the amount of the recovery to the debt actually secured.[3]

The divergence of opinion is clearly one rather of practice than principle, as in any event the pledgee cannot by the suit become the *beneficial* owner of a sum larger than the debt.

One who places in the hands of another, upon information from the latter that certain bonds had been placed in a bank as collateral, money with which to purchase them, is not bound by an agreement made by this other as to the bonds. He is a purchaser from the bank, and can enforce the bonds accordingly.[4]

In a suit where it was held the purchaser at a foreclosure sale under a decree whereby a second mortgagee was not cut off, could redeem from such second mortgage by paying the amount due, it was held that bonds given as collateral security only were binding to the extent of the debts secured thereby, and not as valid for their face.[5]

Bonds of a railroad company properly and legally executed and secured by mortgage, if placed with the president of the company, not due as appears on their face, and by him pledged as collateral to a broker, a purchaser in good faith, for value of these bonds, when regularly and properly sold by the broker, will obtain a clear title to the bonds, and be entitled to have enforced for his benefit the mortgage which secures them.[6]

§ 68. **Whether the Benefit of the Mortgage clear of Equities between the Original Parties passes with a Transfer of the Bonds.** —

[1] Wheelwright *v.* St. Louis, etc. Transportation Co. (1893), 56 Fed Rep. 164.

[2] Simmons *v.* Taylor (1885), 23 Fed. Rep. 849, 857.

[3] Jesup *v.* City Bank (1861), 14 Wis. 331; Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush, 673; s. c. 18 Am. Ry. Rep. 221.

[4] Miller *v.* Rutland & W. R. Co. (1867), 40 Vt. 399.

[5] Simmons *v.* Taylor (1885), 23 Fed. Rep. 849.

[6] Pittsburg, C. C. & St. L. Ry. Co. *v.* Lynde *et al.* (Ohio, 1896), 44 N. E. Rep. 596. The court said, in the opinion: "Where this class of paper, complete in form, and transmissible by delivery, is placed by the maker or owner in the custody of one who is thereby clothed with an apparent power of disposition, and the custodian avails himself of the opportunity thus afforded him to negotiate it to an innocent party, the title of the holder is not to be tested by principles applicable to stolen securities, but by principles properly applicable to the transaction as it actually occurred." See Railway Co. *v.* Sprague, 103 U. S. 756; Fearing *v.* Clark, 16 Gray (Mass.), 74.

This is a question which can scarcely be said to be settled, at least if a corporate mortgage is to be placed on the same footing as mortgages given to secure ordinary notes or other evidences of indebtedness.[1]

But the Supreme Court of Illinois, one of those which has adopted the doctrine that the mortgage is subject to equities even when a *bona fide* holder of the instrument secured is suing thereon, has expressly decided that another rule is properly applied in the case of railroad coupon bonds, intended to be thrown on the market and held as permanent investments, and that to hold otherwise would be doing violence to the manifest intention of the parties, and would unquestionably lead to very disastrous consequences.[2]

§ 69. **Doctrine of Lis Pendens does not apply.** — Where a bondholder acquires bonds pending a litigation, the bonds being negotiable in form, it is immaterial whether or not he has notice of a foreclosure suit, for instance, as the doctrine of *lis pendens* does not apply to a purchaser of bonds for value.[3]

The doctrine of *lis pendens* does not apply to negotiable paper transferred before due, in due course of business, for value.[4]

[1] As to the conflict of opinion in regard to such mortgages, see Daniel's Negot. Instr., sect. 834.

[2] Peoria & Springfield R. Co. *v.* Thompson (1882), 103 Ill. 187, disapproving on this point Chicago, etc. Ry. Co. *v.* Loewenthal (1879), 93 Ill. 433.

[3] Farmers' & Merchants' National Bank *v.* Waco Electric Ry. & Light Co. *et al.* (1896, Tex. Ct. App.), 36 S. W. Rep. 131, 135.

[4] Pittsburg, C. C. & St. L. Ry. Co. *v.* Lynde *et al.* (Ohio, 1896), 44 N. E. Rep. 596.

CHAPTER III.

RIGHTS OF COUPON-HOLDERS.

§ 70. **Introductory.** — It is not within the scope of this work to narrate the history of the rates of interest upon railroad bonds in this country, nor to discuss the principles which govern in determining what rates have been and should be obtained. The capital which has built the roads of this country is, speaking generally, represented by their bonded debt. The non-payment of interest has been the usual basis for railway foreclosures and reorganizations. Such interest is usually evidenced by coupons.

The term "coupon" or "interest warrant" is applied to an instrument attached to a bond, evidencing the right to interest upon the bond for a specific period of the life of the bond, usually six months, sometimes three months, and rarely one year. This instrument, as it is substantially complete in itself, and capable of being severed from the bond, is often dealt with and treated for many purposes as independent of the bond to which it was originally attached.[1]

The general idea as to coupons and the bonds to which they are attached which has governed the courts has been that they are of modern invention, and should have the effect intended by

[1] In Sanborn *v.* Clough (1887), 64 N. H. 315; s. c. 10 Atl. Rep. 678, it was held that coupons being, in legal effect, equivalent to separate bonds for instalments of interest, passed to a legatee as bonds under a clause by which he was to receive "all the rest of all the testator's money in banks, stocks, and bonds."

In Clokey *v.* Evansville & T. H. R. Co. (1897), 44 N. Y. Supp. 631, the Appellate Division of the Supreme Court of New York held that the holder of a detached coupon could not recover the amount of his coupons of a company which had guarantied the bonds on this guaranty. O'Brien, J., dissented.

the parties, and be governed by the usage of the country, and not by sharp rules of law applicable to instruments of a different nature. Thus the possession of coupons is *prima facie* evidence that the holder of them is holder of the bond (or was so, at least, when they were cut off), and as such entitled to receive the interest.[1]

§ 71. **Rate of Interest on Bonds.**[2] — (a) *Stipulation to pay Interest in Gold, Meaning of.* — A contract to pay 8 per cent in gold is not a contract to pay more than 8 per cent, for the reason that when the interest falls due gold may happen to be at a premium. Whether interest in gold is better than interest in currency depends upon contingencies not to be foreseen.[3]

(b) *Rate of Interest cannot be changed to Prejudice of other Lienors.* — Where an extension of the time of payment of bonds has been agreed upon between the bondholders and the company, with the consent of a majority of its stockholders (the interest to be payable in gold instead of in currency as theretofore), but the agreement was to be subject to confirmation by the courts, the consideration that it may prove an injury to the second-mortgage bondholders, as being tantamount to increasing the rate of interest, has been held to be probably a sufficient reason for a court's withholding its approval.[4]

But this ruling might, it seems, have been made without any qualification, as it has been expressly decided that an enactment providing for a substitution of bonds of a company to secure a loan from the State, the new bonds to bear an increased rate of interest, is, to the extent of the increase, an invasion of the rights of holders of first-mortgage bonds who had agreed to allow the State security to have priority over their mortgage, inasmuch as these holders had the right to claim that only bonds for so much a mile, as agreed upon, and bearing the first-named lesser rate of interest, should be made superior to theirs.[5]

[1] See cases cited in notes to § 74, *post*.

See article on "Coupons" by Charles W. Hassler in 4 Cent. L. J. 315 (1877); Durant *v.* Iowa County (1864), 1 Woolw. 69; s. c. 8 Fed. Cas. 117, Case No. 4189.

[2] As to the rate of interest as affecting the validity of bonds, see Chap. I. § 9.

[3] Young *v.* Montgomery & Eufaula R. Co. (1875), 2 Woods, 606, 614.

[4] Taylor *v.* Atlantic & Great Western Ry. Co. (1877), 55 How. Pr. 275. The Ohio court ratified the agreement, while that New York court declined to do so on the ground stated in the text. In Reinach *v.* Meyer (1877), 55 How. Pr. 283, this ruling was approved and acted upon by another New York court.

[5] Campbell *v.* Texas & N. O. R. Co. (1872), 2 Woods, 263.

As to the inability of the legislature to validate, as against non-assenting bondholders, a scheme of reorganization which, among other features, contemplates an exchange of the original bonds for new ones at a lower rate of interest, see Chap. XXVII. (Reorganization).

(c) *Party subrogated to Rights of Lienor can claim only Legal Rate of Interest.* — Where a junior incumbrancer protects the property against a forced sale by a prior lien, and then becomes subrogated to the rights of the latter to the extent of the sum paid, the court in reimbursing him for this outlay should allow whatever is the legal rate of interest at the time of the contract, and not the rate stipulated for by the prior lienor.[1]

(d) *Rate of Interest on Bonds not paid at Maturity.* — In some States the rate of interest on commercial paper which is not paid at maturity is the statutory rate, whether that is higher or lower than the contract rate. But the doctrine most generally accepted is that the contract rate is payable after, as well as before, maturity, though the rate fixed by the general law may be lower.[2]

[1] Memphis & Little Rock Railroad *v.* Dow (1887), 120 U. S. 287; s. c. 7 Sup. Ct. Rep. 482. In this case the facts were that a reorganized company had covenanted in its mortgage that the interests conveyed were free from incumbrances, and that it would warrant and defend the title against all lawful claims whatsoever. The debt due the State by the terms of her contract with the old company bore interest at the rate of 8 per cent per annum until paid. The entire claim with interest at that rate was paid by the trustees. The constitution of the State prohibited any contract for interest above 10 per cent, and fixed the legal rate at 6 per cent. By statute, judgments on decrees upon contracts bearing more than 6 per cent interest were to bear the same interest as might be specified in such contracts, and the rate of interest was to be expressed in all such judgments and decrees, while all other judgments carried 6 per cent. The court, in considering what these trustees were entitled to in the way of interest, used the following language: "The right of subrogation is not founded on contract. It is a creature of equity, is enforced solely for the purpose of accomplishing the ends of substantial justice, and is independent of any contractual relations between the parties. All that these trustees can in good conscience demand is *reimbursement* for their outlay in protecting the mortgaged property against the prior lien of the State. When relief to that extent is accorded they will have no just ground to complain, especially as the debt held by the State was not the personal debt of the reorganized company. There was no agreement between them and this company in respect to interest upon any sum they might be compelled to pay in order to relieve the property from prior incumbrances." The trustees, therefore, were adjudged to have a lien upon the mortgaged property for the whole amount actually paid to the State, with interest thereon from the date of such payment at the rate established by law in cases where there was no agreement as to rate.

[2] Cases applying this rule to bonds are Cromwell *v.* Sac Co. (1877), 96 U. S. 51; Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 673; 18 Am. Ry. Rep. 221; Langston *v.* South Carolina R. Co. (1870), 2 S. C. 248; Cheever *v.* Rutland, etc. R. Co. (Vt., 1869), 4 Am. Ry. Rep. 291; Beckwith *v.* Trustees (1860), 29 Conn. 268. In the last case the court very clearly explains the *rationale* of the doctrine as follows: "This, though an arbitrary rule, will generally operate justly, and is much more convenient than any other which could be adopted. But the usual rate of interest at any place, which, of course, is but another mode of speaking of the legal rate at such place, is itself as arbitrary a provision of law as the damages dependent upon it, and is by no means uniform. It is not only known to differ in different States and countries, generally depending upon positive statutes, but may vary from the ordinary or more general rate by the parties agreeing upon a lesser rate, or, if authorized so to

Where the bonds and coupons are both silent as to the rate of interest after the coupons are in default, interest is payable at the rate fixed by the law of the place where the coupons are payable;[1] until the claim is merged in judgment, after which the law of the former governs.[2]

But if the parties contract with reference to the law of one State and appoint a place of payment in another State, merely for the reason that it is a convenient financial centre, interest will be adjudged at the rate established in the former State.[3]

(e) *Coupons falling due after Maturity of Principal owing to Election to have Principal due are deemed to be cancelled.* — The election of the bondholders to treat a default in the payment of interest as a forfeiture of the contracts, so far as they prescribe the length of time for which the bonds were to run, operates *prima facie* to cancel all coupons representing instalments of interest not then due.[4]

§ 72. **Whether Coupons are entitled to Days of Grace.** — The

do, as in the case under consideration, by their agreement upon a higher rate for money borrowed for some particular purpose, or by a particular class of persons or corporations; as is the case in respect to money borrowed by railroad companies under the act of 1849. Rev. Stat. (Comp. 1854), 750, § 23. And the different rates thus agreed upon become the legal rates of interest in respect to particular contracts during their existence. And the rates of interest thus established by agreement must be presumed to be just and equitable under the circumstances; that is, a fair compensation in such case for the use of money between the parties during the time the contract had to run. Then why should we not presume, as between the same parties, that such interest continues a fair compensation for its use until the contract is performed, as well after as before the day when the principal was to be paid, and thus permit the rate of interest agreed upon to control the damages to be paid for the detention of the money, as well as the interest for its use? There is no equity in favor of one rate of interest rather than another, where they are both legal, and within reasonable limits, and the defendants ought not to complain so long as it is in their power, by paying the principal, to protect themselves from paying what they thought a reasonable rate when they borrowed the money." The statutes and decisions of each State where this question arises must, however, be examined. It was held error to allow interest on past due coupons in Buffalo Loan Co. *v.* Medina Gas & Electric Light Co. *et al.*, 12 App. Div. 199.

1 Scotland County *v.* Hill (1889), 132 U. S. 107; s. c. 10 Sup. Ct. Rep. 26.

2 Ibid.

3 Codman *v.* Vermont & Canada R. Co. (1879), 16 Blatch. 165; Cheever *v.* Vermont, etc. Ry. Co. (1869), 4 Am. Ry. Rep. 291; Cromwell *v.* County of Sac (1877), 92 U. S. 51; Jackson & Sharp Co. *v.* Burlington, etc. R. Co. (1887), 29 Fed. Rep. 474. See also Fauntleroy *v.* Hannibal (1879), 5 Dill. 219; s. c. 8 Fed. Cas. 1093, Case No. 4692, affirmed in Hannibal *v.* Fauntleroy, 105 U. S. 408; Phelps *v.* Lewiston (1878), 15 Blatch. 131; s. c. 19 Fed. Cas. 450, Case No. 11,076; Clarke *v.* Janesville (1856), 1 Biss. 98; s. c. 5 Fed. Cas. 962, Case No. 2854; First National Bank of North Bennington *v.* Bennington, 16 Blatch. 53; s. c. 9 Fed. Cas. 97, Case No. 4807.

4 Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush, 673; s. c. 18 Am. Ry. Rep. 221.

New York courts have taken the ground that coupons payable to bearer at a fixed time and place, being in legal effect promissory notes, necessarily have all the characteristics of such instruments, and are entitled to the benefit of the days of grace allowable on bills and notes payable at a given day or time.[1]

But the Supreme Court of Massachusetts is of a different opinion, holding that the reasons why days of grace were allowed on foreign bills of exchange payable at sight or at a future day certain have little application to coupon bonds issued by corporations, which usually have a long time to run and are commonly bought as an investment.[2]

§ 73. **Interest on Coupons after Default.** — That interest is recoverable upon coupons from the time they are in default is universally conceded.[3]

This interest is allowed by way of damages as a compensation for the delay of payment.[4]

The allowance of interest on coupons after demand and refusal of payment is not open to objection on the ground that it is an infringement of the laws against usury.[5]

The default on coupons payable on presentation and demand is only complete from the time of presentation and demand, and the interest on them will not begin to run till then.[6]

[1] Evertson *v.* National Bank (1876), 66 N. Y. 14, holding that one purchasing before the days of grace expire is a purchaser before maturity. This is immaterial in New York now, as days of grace have been abolished.

[2] Chaffee *v.* Middlesex R. Co. (1888), 146 Mass. 224; s. c. 16 N. E. Rep. 34. In this case the only question actually decided was that interest warrants payable to bearer, when detached from the bonds with which they were issued, were not negotiable notes within the meaning of Massachusetts Rev. Stat., ch. 77, § 9; but the court expressly dissented from the New York case just cited. The statutes of each State must be consulted on this point.

[3] Dan. Neg. Inst., sect. 1513; Town of Genoa *v.* Woodruff (1875), 92 U. S. 502; Aurora City *v.* West (1868), 7 Wall. 82; Commonwealth *v.* Chesapeake & Ohio Canal Co. (1870), 32 Md. 501; Welsh *v.* St. Paul, etc. R. Co. (1879), 25 Minn. 314; North Penn., etc. R. Co. *v.* Adams (1867), 54 Pa. St. 94; County of Beaver Co. *v.* Armstrong (1862), 44 Pa. St. 63; Phila., etc. R. Co. *v.* Fidelity, etc. T. Co. (1884), 105 Pa. St. 216; Phila., etc. R. Co. *v.* Knight (1889), 124 Pa. St. 58; Langston *v.* S. C. R. Co. (1870), 2 S. C. 248; Ashuelot R. Co. *v.* Elliot (1874), 57 N. H. 397; s. c. 13 Am. Ry. 491; Humphreys *v.* Morton (1881), 100 Ill. 592; Phila. & Read. R. Co. *v.* Smith (1884), 105 Pa. St. 195; s. c. 29 Am. & Eng. R. R. Cas. 400; Gibert *v.* Wash. & Gt. So. R. Co. (1889), 33 Gratt. 586; s. c. 1 Am. & Eng. R. R. Cas. 473.

[4] Connecticut Mut. Life Ins. Co. *v.* Cleveland, Cincinnati, etc. R. Co. (1863), 41 Barb. 9; Codman *v.* Vermont, etc. R. Co. (1879), 16 Blatch. 165, adhered to in Codman *et al.* *v.* Vermont & Canada R. Co. (1879), 17 Blatch. 1; s. c. 5 Fed. Cas. 1162, Case No. 2936; Cheever *v.* Vermont, etc. R. Co. (Vt., 1869), 4 Am. Ry. Rep. 291, and cases cited above.

[5] County of Beaver *v.* Armstrong (1862), 44 Pa. St. 63.

[6] Corcoran *v.* Ohio, etc. Canal Co. (1874), 1 MacArthur (D. C.), 358; Aurora

On the other hand, if there are no funds at place of payment, interest runs after maturity without presentation;[1] though if the company has funds sufficient to meet the coupons and other obligations at the place named for payment, it will not be held liable for interest merely because the money for the payment of the coupons is not segregated from its other funds.[2]

§ 74. **Negotiability and Transfer of Coupons generally.** — (a) *When Coupons are negotiable.* — The rules of law applicable to coupons of municipal bonds and railroad bonds are in the main the same, the decisions as to each class of coupons being cited indifferently by the courts irrespective of the character of the obligor.

Interest coupons are instruments of a peculiar character. The title passes from hand to hand by delivery.[3]

Bonds executed by a railroad company may not be put upon the market until one or more coupons have matured. The company may cut them off when it sells the bonds, or leave them to be accounted for in the purchase.[4]

When *payable to order and indorsed in blank*, or *payable to bearer*, they are transferable by delivery, and subject to the same rules and regulations, so far as respects the title and rights of the holder, as negotiable bills and promissory notes. Holders are as effectually shielded from the defence of prior equities between the original parties, if unknown to them at the time of the transfer, as the holder of any other class of negotiable instruments. A transfer of possession is presumptively a transfer of title, but does not import a guaranty of payment.[5]

City *v.* West (1868), 7 Wall. 82; Pekin *v.* Reynolds (1863), 31 Ill. 529; Whitaker *v.* Hartford, Prov. & F. R., etc. Co. (1864), 8 R. I. 47; Nat. Exchange Bk. *v.* Hartford, Prov. & F. R. Co. (1866), 8 R. I. 375; Fitchett *v.* North Penn. R. Co. (1863), 5 Phil. 132.

[1] North Penn., etc. R. Co. *v.* Adams (1867), 54 Pa. St. 94; Marlor *v.* Texas, etc. R. Co. (1884), 21 Fed. Rep. 383.

[2] Emlen *v.* Lehigh Coal & Navigation Co. (1864), 47 Pa. St. 76.

[3] Ketchum *v.* Duncan (1877), 96 U. S. 659, 662, affirming Duncan *v.* Mobile & Ohio R. Co. *et al.* (1877), 3 Woods, 567; s. c. 8 Fed. Cas. 19, Case No. 4138.

[4] Railway Co. *v.* Sprague (1880), 103 U. S. 756; s. c. 26 L. ed. 554.

[5] Ketchum *v.* Duncan (1877), 96 U. S. 659, 662; Myers *v.* York & Cumberland R. Co. (1857), 43 Me. 232; Jackson *v.* York & Cumberland R. Co. (1858), 48 Me. 147 (see a note on this case by Mr. Redfield in 2 Am. Ry. Law, 595); Nat. Exchange Bank *v.* Hartford, Prov. & F. R. Co. (1866), 8 R. I. 375; Haven *v.* Grand Junction R. & Depot Co. (1871), 109 Mass. 88; Grand Rapids & Ind. R. Co. *v.* Sanders (1877), 54 How. Pr. 214; Hand *v.* Sav. & Charleston R. Co. (1879), 12 S. C. 314; Same *v.* Same (1881), 17 S. C. 219; 12 Am. & Eng. R. R. Cas. 495; County of Beaver *v.* Armstrong (1862), 44 Pa. St. 63; Thomson *v.* Lee Co. (1865), 3 Wall. 327; Connecticut, etc. M. Co. *v.* C. C. & C. R. Co., 41 N. Y. 921; Ide *v.* Passumpsic, etc. R. Co., 32 Vt. 297; Gelpcke *v.* City of Dubuque, 1 Wall. 175; Meyer *v.* City of Muscatine (1863), 1 Wall. 384;

Railroad coupons are not rendered non-negotiable by the fact that they are not made payable to a particular person.[1]

The principle that coupons are negotiable instruments has no application in a case where the rights of the parties are dependent merely on the true construction of a public statute. A provision in such a statute waiving the liens of the State in favor of certain bonds to be issued, "so as to make such bonds and interest to accrue thereon" preferred liens "until such bonds and interest shall be fully paid," is a waiver only in favor of the bonded debt and simple interest that may accrue thereon, and does not extend to interest that may accrue on the coupons.[2]

(b) *When Coupons are not negotiable.*—An interest warrant or coupon not made payable *to bearer* or *order* is not negotiable when separated from its bond, although the latter is negotiable.[3]

Coupons which, by appropriate references, are made subject to conditions in the mortgage under which the time of payment of the debt secured thereby can be changed and postponed at the option of a majority of the bondholders lack one of the essential characteristics of negotiable paper.[4]

§ 75. **Recovery on Detached Coupons.** — Coupons are written contracts for the payment of a definite sum of money on a day named, being purposely drawn and executed in such a form and manner that they may be separated from the bonds with which they are negotiated. After being so separated, they retain the same nature and character as to security as the bonds, and do not become simple contracts.[5]

They are attached to bonds in the expectation that they will be paid as they mature, however distant the period fixed for the payment of the principal. Upon being severed from the bonds, they cease to be incidents of the bonds, and become, in fact, independent claims. They do not lose their validity if for any cause the bonds are cancelled or paid before maturity, or their negotiability, or their capacity to support separate actions.[6]

Seybert *v.* City of Pittsburg (1865), 1 Wall. 272; Van Hostrup *v.* Madison City (1863), 1 Wall. 291, 294; Mercer County *v.* Hackett (1863), 1 Wall. 83; Murray *v.* Lardner (1864), 2 Wall. 110; Sheboygan County *v.* Parker (1865), 3 Wall. 93.

[1] Smith *v.* Clark County (1873), 54 Mo. 58.

[2] Commonwealth *v.* Chesapeake & Ohio Canal Co. (1870), 32 Md. 501.

[3] Evertson *v.* National Bank (1876), 66 N. Y. 14. A holder of overdue coupons of bonds of a railroad company cannot sue on them and enforce his judgment against the income of the company. Roberts *v.* Denver, L. & G. R. Co. (Colo. App.), 46 Pac. Rep. 880.

[4] McClelland *v.* Norfolk Southern R. Co. (1888), 110 N. Y. 469; s. c. 18 N. E. Rep. 237.

[5] City *v.* Lamson (1869), 9 Wall. 477.

[6] Clark *v.* Iowa City (1874), 20 Wall. 586; s. p. Nat. Exchange Bank *v.* Hartford, P. & F. R. Co. (1866), 8 R. I.

To enable the holder to maintain such a suit, it is not necessary that the bond itself should be produced. As was said by Mr. Justice Nelson in a leading case: "These coupons or warrants for the interest were drawn and executed in a form and mode for the very purpose of separating them from the bond, and thereby dispensing with the necessity of its production at the time of the accruing of each instalment of interest, and at the same time to furnish complete evidence of the payment of the interest."[1]

375; State *v.* Spartanburg & N. R. Co. (1874), 8 S. C. 129; Tyrell *v.* Cairo & St. Louis R. Co. (1879), 7 Mo. App. 294; McClelland *v.* Norfolk Southern R. Co., 110 N. Y. 469 (see note to this case 1 Lawyers' Reports Ann. 299); Evertson *v.* Nat. Bank (1876), 66 N. Y. 14; Duncan *v.* Mobile, etc. R. Co. (1877), 3 Woods, 567; Stevens *v.* New York, etc. R. Co. (1876), 13 Blatch. 412. In Sewall *v.* Brainerd (1865), 38 Vt. 364, though the bond was to pay A. B. or bearer "with interest at the rate of 7 per cent per annum, payable semi-annually on presentation of the interest coupons hereto attached," it was held that, as the coupons were made payable to bearer, and as the coupon only was required to be presented when paid, it was more reasonable to suppose the intention was to pay the coupon to the holder of the coupon in case it should be severed and sold without the bond.

In Maine the authorities indicate some wavering of opinion. At first the Supreme Court adopted the commonly received doctrine as to the potency of custom to impart a negotiability to the coupons, the ruling in Myers *v.* York & C. R. Co. (1857), 43 Me. 232, being that, *in the absence of proof of custom as to the negotiability of coupons or interest warrants disconnected from the bonds with which they were issued*, an independent negotiable character cannot be given them without the interposition of the legislature, unless the intention of the party issuing them distinctly so appears upon the face of the coupon itself. But when the question again came a few years later, in Jackson *v.* York, etc. R. Co., 48 Me. 147 (1858), it was held (though by a divided court), that, in the absence of some statutory provision, no action could be maintained, in the name of an assignee, upon interest coupons which contain no negotiable words, nor any language from which it can be inferred that it was the design of the company to treat them as negotiable paper, or as creating any obligation distinct from and independent of the bonds to which they were severally attached. The court based its opinion on the theory that each of the coupons in question should continue to be part of the instrument until it became due and payable, and rejected evidence of custom as bearing on the character of the coupons, asserting that whether paper is negotiable or not is a question of law, to be determined from the paper itself by fixed and well-settled rules. The earlier case was not referred to by the court, but its concession that custom alone can render such instruments negotiable was clearly inconsistent with this ruling as to evidence. The doctrine thus formulated was adhered to in Augusta Bank *v.* City of Augusta (1860), 49 Me. 507, where it was denied that a coupon, not payable to order or bearer, or containing other equivalent words, was negotiable. The court said that a coupon to be negotiable must be so upon its face without reference to any other paper, and that a coupon not negotiable on its face will not be held to be so upon proof that similar coupons have been passed from hand to hand as if negotiable.

In an early case in the Court of Common Pleas of Ohio it was held that an interest coupon, which has no payee designated therein, is not a negotiable instrument, and that the purchaser of such a coupon cannot, by reason of the interest so acquired, maintain an action in his own name to enforce the mortgage. Wright *v.* Ohio, etc. R. Co. (1857), 1 Disney, 465.

[1] Commrs., etc. *v.* Aspinwall (1858), 21 How. 539; S. P. Aurora City *v.* West (1868), 7 Wall. 82; Commonwealth *v.* Chesapeake & Ohio Canal Co. (1870), 32 Md. 501.

While coupons are recognized as *choses in action* having many of the incidents of commercial paper, transferable from hand to hand when payable to bearer, and bearing interest because payable on a given day, yet, though detached from the bond, they still remain a part of it in contemplation of law, and are protected by and subject to the covenants which it contains.[1]

A severed coupon being an independent obligation, the debt evidenced by the coupon cannot be recovered as interest in an action on the bonds after the Statute of Limitations has run against the coupon itself.[2]

§ 76. **Rights of Purchasers of Stolen or Lost Coupons.** — It has been seen in the preceding chapter that the fact of a negotiable bond having been stolen will not invalidate the title of a *bona fide* purchaser who subsequently acquires it before its maturity. The same rule holds in regard to the interest coupons of such bonds, provided they are drawn in such terms as to be themselves negotiable instruments.[3]

If the purchaser has bought stolen bonds with the coupons attached, some of them overdue and some of them not yet matured, he takes a clear title as to the latter only.[4]

When the maker of a bond has notice that it has been stolen, he is bound to act on the supposition that the paper is still in the possession of the thief, and to refuse to pay it to any holder who cannot show that he is an innocent purchaser.[5]

And if such maker pays to the purchaser any overdue coupons, he will be liable to the real owner whether the purchaser is a *bona fide* holder or not, as these coupons will then have lost all their virtue as negotiable paper.[6]

One who purchases a non-negotiable coupon detached from

[1] State *v.* Spartanburg, etc. R. Co. (1874), 8 S. C. 129.

[2] Griffin *v.* Macon Co. (1888), 36 Fed. Rep. 885, distinguishing these cases from those in which no separate contract to pay instalments of interest is annexed to the obligation.

[3] Evertson *v.* National Bank (1876), 66 N. Y. 14.

[4] Gilbough *v.* Norfolk, etc. Co. (1877), 1 Hughes, 410.

[5] Bainbridge *v.* Louisville (1885), 83 Ky. 285.

[6] Bainbridge *v.* Louisville (1885), 83 Ky. 285. In this case the court considered that the usual course of requiring the obligor to pay the original owner of a stolen bond, upon his tendering a bond of indemnity, was not appropriate in a case where the lost bonds are numerous and will not mature for several years. An amendment to the petition so as to make it ask for an injunction against the obligor to prevent it from paying any of the bonds until his right as against the original owner should be determined, with an order requiring the obligor to make each claimant a party, as each bond or coupon should be presented, so that he might litigate his rights with the real owner, the case being kept on the docket for that purpose, was thought to be a more effectual mode of securing the various parties.

a negotiable bond acquires no title thereto if it has been stolen.[1]

The holder of lost coupons, upon tendering indemnity, is entitled to recover thereon with interest from the date of demand.[2]

§ 77. **Whether Coupons have been bought or paid.** — It happens not infrequently that persons interested in the financial condition of a company take up maturing coupons themselves, or advance money to the company for that purpose. It then becomes essential to determine the precise character of the transaction. This, it is plain, must be, in every case, a matter of evidence as to the intention and understanding of the parties interested. But the effect to be given to such evidence is materially different according as the person who furnished the money is seeking to establish his position as a secured creditor against other secured creditors, or merely against unsecured creditors. The rule, as now settled, has been thus stated by the New York Court of Appeals: Interest coupons received by one who has advanced the money with which they were taken up, under an agreement that they were to be delivered to him uncancelled as security for the advances, are, as against the corporation, valid securities in the hands of the holder, and a mortgage upon the corporate property given to secure the bonds may be enforced for his benefit. But as between him and bondholders who received the amount of their coupons in ignorance of the transaction, and supposing them to have been paid, the latter have the prior equities; and if the proceeds of sale after foreclosure are not sufficient to pay the face of the bonds, the company cannot share in the proceeds.[3]

The latter half of this rule is a special application of the familiar principle that a court of chancery will uphold a mortgage for the benefit of a party who has advanced money upon it when equity requires it; but will not convert a payment into a purchase in favor of a party advancing the money, when there is a superior countervailing equity in another party.[4]

[1] Evertson *v.* National Bank (1876), 66 N. Y. 14.

[2] Fitchett *v.* Northern Penn. R. Co. (1683), 5 Phil. 132.

[3] Union T. Co. *v.* Monticello & Port Jervis Ry. Co. (1875), 63 N. Y. 311.

[4] Miller *v.* Rutland & Washington R. Co. (1867), 40 Vt. 399. In this case the purchaser took up the coupons on the faith of an agreement that he should have the benefit of the mortgage. The court thus examined all the adverse claims, and showed that there was no equity in any of them superior to that of the purchaser, and said: "The corporation cannot object in the face of their agreement. The third-mortgage bondholders cannot object, for these coupons are a part of the original mortgage debt under this prior mortgage. If it appeared that Bradley represented to them when they took their mortgage that the coupons were paid, the case might be different. The third mortgages are in no worse condition if these

A review of the cases shows that the rights of the parties depend principally upon whether the agreement under which the coupons were taken up was known to the other secured creditors or not.[1]

The theory which underlies the cases denying the lender equal rights with other secured creditors is that, although such arrangements, as between him and the company, are allowable,—a legitimate mode of furnishing pecuniary aid to the company, changing the form, but not increasing the amount of the actual debt,—the lender is estopped, as against the secured creditors who supposed that the coupons surrendered by them were paid in the usual course of business, from coming forward as a purchaser and assignee, and diminishing the dividend which such creditors are entitled to receive from the proceeds of the mortgaged property.[2]

coupons are allowed as now presented, than if they still remained unpaid attached to the bonds; neither are the first mortgagees, so far as it appears. But it is said that these coupons being taken up in the manner they were, the bondholders under the first mortgage had a right to suppose it was a payment, and may have thereby been induced to postpone proceedings to foreclose their mortgage. This is a mere conjecture. It may be so, and may not. But whether it is or not, if this mortgage is redeemed, it is no prejudice to them to have these coupons allowed, as they will get their whole debt. It cannot be assumed that it will not be redeemed. But if it is not redeemed, it does not appear, nor is it claimed in argument, that the property is insufficient in value to pay the whole of this first-mortgage debt, including these coupons; so that in either event the first-mortgage bondholders will receive their whole pay. No equity should be crowded out when there is enough to pay all. This will not be done even in a case of a subsequent lien; much less against a party who holds a part of the original first-mortgage debt. But it is insisted that the allowance of these coupons interferes with the chance of the first-mortgage bondholders obtaining this property by foreclosure for less than its value. That is a chance that must be postponed till all equitable liens are discharged. It cannot be allowed to stand in the way of an equity so obvious as this. A mortgagee who wishes to speculate out of the mortgage security by getting more than his full pay, at the sacrifice of a holder of a part of the mortgage debt, must do it without the aid of a court of equity.

[1] Circumstances which were held sufficient in a leading decision to warrant the inference that coupons were bought were, that the money was not received by the company itself or any one under a duty to act for it; that the transferees of the coupons had repeatedly informed the holders of the bonds and the rest of the coupons, that a purchase, not a payment, was intended; that the coupons in question had been preserved uncancelled. Ketchum *v.* Duncan (1878), 96 U. S. 659, affirming Duncan *v.* Mobile, etc. R. Co. (1877), 3 Woods, 567. This case was followed in Claflin *v.* South Carolina R. Co. (1880), 8 Fed. Rep. 118, 138, where Chief Justice Waite, upon a review of the evidence, especially the publicity given to the fact that the transaction was intended as a purchase, reached the conclusion that it should be treated as in law a purchase. The fact that the agreement was undisclosed was also relied on in Cameron *v.* Tome (1886), 64 Md. 507; s. c. 24 Am. & Eng. R. R. Cas. 213; 2 Atl. Rep. 837; Union T. Co. *v.* Monticello, etc. Ry. Co. (1875), 63 N. Y. 311; South Covington Ry. Co. *v.* Gest (1888), 34 Fed. Rep. 628.

[2] Haven *v.* Grand Junction R. Co. (1871), 109 Mass. 88.

This consideration is entitled to special weight in the case of subsequent purchasers of the bonds and coupons, whose estimate of the value of these evidences of debt must be more or less influenced by the fact that a portion of the interest is or is not still unpaid, and is decisive where the coupons have been paid by one who has guarantied their payment.[1]

Where the person asserting himself to be the owner of the coupons is the financial agent of the company charged with the duty of receiving and applying its earnings to the payment of its debts, including coupons as they mature, and such earnings have been blended and confused with his private funds, there is no presumption in his favor, arising from his retention and possession of the coupons. Nor can a resolution passed by the company, after the coupons were actually taken at his instance and to serve his purpose, have any effect upon the relations between the parties, for those were fixed at the time the coupons were surrendered by the holders.[2]

Where the lien of the coupons has once ceased to exist, it cannot be revived, as against other secured creditors, by any subsequent arrangement between the company and party whose money paid off the coupons.[3]

[1] In Child *v.* New York & New England R. Co. (1880), 129 Mass. 170; s. c. 2 Am. & Eng. R. R. Cas. 329, a certain railway company under a contract with another had paid off certain coupons for interest, and afterwards claimed to have equal rights with the bondholders in a reorganization plan of the latter company. The court say: "The holders bought their bonds with the agreement of this company indorsed upon it, and upon the faith of that agreement, which is essentially a guaranty. The company agrees that the several interest warrants shall be paid as they mature. If the maker of the bonds did not pay the interest, it was the duty of the guarantor to pay it. When these bondholders received the amounts of the interest warrants, they had the right to regard it as payment and extinguishment of the interest which diminished the amount of their debt and strengthened their security."

[2] South Covington, etc. Ry. Co. *v.* Gest (1888), 34 Fed. Rep. 628.

[3] South Covington, etc. Ry. Co. *v.* Gest (1888), 34 Fed. Rep. 628. In this case a bondholder agreed with a company to pay off its pressing debt, including certain coupons for interest, upon receipt of the company's notes for $15,000, due at different times, he to hold the coupons, when taken up, as collateral security, and that, as fast as the notes were paid, coupons to a proportionate amount were to be surrendered to the company. An outsider agreed with him that he would buy him out if he would secure his being placed in full control of the road. This was done, and the latter raised the money on the company's notes, and paid the bondholder, and had turned over to him, not only the coupons detached from this bondholder's bonds, but certain others that had been paid to other holders, when presented at the company's office, and had passed into this bondholder's hands without the knowledge or consent of the former holders. Concerning the effect of this transaction the court say: "This bondholder had realized money on the notes; this money in his hands was applicable to the payment of these coupons which he undertook to pay off with the

§ 78. **Rights of Persons participating in Arrangements for funding Coupons.** — When coupon-holders accept a scheme which involves the funding of overdue interest, and the issue of new evidences of debt in place of their unpaid coupons, the presumption is that there is no novation in their contract, and that they are still entitled to the benefit of the security of the mortgage; and this presumption can be overcome only by clear evidence that it was their intention to waive their lien.[1]

It is immaterial that the new evidences of debt are under seal, and the coupons only simple contracts, for the bonds themselves are also sealed instruments, and it is by force of these that a lien and priority are secured to the bondholder both for the principal sum and for the interest thereon. Nor can the acceptance of such evidences of debt be made to operate as payment of the interest funded, on the ground that by their terms the coupon-holder obtains the obligation of the company to pay interest on interest, the result being a new and different contract between the parties. As the bondholder is entitled to interest on the coupons from the time of their maturity, the new instruments merely secure in express terms something which the bondholder already possessed, and therefore changes neither the rights nor the obligations of the parties.[2]

proceeds thereof. With the receipt of that money said coupons, as between him and the company, were paid. The coupons were not turned over to the party or parties who purchased, or discounted and held, the notes before maturity, but they were delivered up to the one who was then the sole managing and financial agent of the company, and the proper officer to receive and cancel the same as no longer subsisting liabilities of the company. When the arrangement was made with the company afterwards to surrender the notes and hold the coupons absolutely, they constituted nothing more than newly issued evidences of debt. Other holders of first-mortgage bonds and outstanding coupons due or to become due could not be affected by the substitution, nor could said coupons be reinvested with the lien which had once ceased, even for a moment, to exist." See, as to an agreement between a third party furnishing the money to pay coupons and the mortgagor not being enforceable against the bondholders, Fidelity Ins. Trust & Safe Deposit Co. *v.* West Pa. & S. C. R. Co., 138 Pa. St. 494; s. c. 21 Atl. Rep. 21, where coupons which have been apparently paid were treated by the court as paid. See Farmers' Loan & Trust Co. *v.* Iowa Water Co., 78 Fed. Rep. 881, decided upon the authority of the case last cited, and Claflin *v.* South Carolina R. Co., 8 Fed. Rep. 118.

1 Skiddy *v.* Atlantic, Mississippi, & Ohio R. Co. (1878), 3 Hughes, 320. In Gibert *v.* Washington, Va. Mid. & Great Southern, etc. R. Co. (1880), 33 Gratt. 586; s. c. 1 Am. & Eng. R. R. Cas. 473, where the company was unable to pay its interest, and gave what they called coupon bonds to the holder, the court held them to be secured by the original mortgage, upon the principle that "so long as the debt exists the courts will never presume the chief security taken for its payment has been surrendered without satisfaction, unless upon the clearest and most convincing testimony."

2 Commonwealth *v.* Chesapeake, etc. Canal Co. (1871), 35 Md. 1.

One who funds coupons under a statute is bound by its terms, not merely as to the coupons actually funded, but also as to any bonds or coupons held by him at the time of funding, at least where they belong to the same class as the coupons funded. The statute operates upon the entire obligation, both principal and interest, and one who accepts its provisions for one purpose accepts it for all purposes. The principle that when a contract is one and indivisible, if it takes effect at all it must take effect as to all its parts, necessarily involves the conclusion that the benefit of such a statute must either be accepted as a whole or rejected as a whole.[1]

§ 79. **Recoupment of Defaulted Interest in an Action to recover Damages for failing to accept Bonds.** — Where a party binds himself on a certain condition to take a certain number of bonds, secured by a mortgage which provides that, if any of the interest on the bonds is not paid within ninety days after it is due, the entire principal and interest shall become immediately due, and receives and pays for a portion of the bonds, he may, in an action brought by the company to recover damages for failing to take the residue, such action being brought after the interest on the bonds paid for has been in default more than ninety days, recoup the amount due thereon against the damages growing out of his refusal to accept and pay for the remaining bonds. The undertaking of the party agreeing to receive the bonds amounts to a promise to make a loan to the company of the amount indicated by the subscription, for the length of time and upon the terms specified in the mortgage. The payment of interest, in this view, is a vital part of the consideration and affects the entire contract.[2]

[1] Hand *v.* Savannah & Charleston R. Co. (1879), 12 S. C. 314, 350. The application of the doctrine stated in the text to the peculiar circumstances of these coupon-holders and other lienors was again under consideration in Hand *v.* Savannah, etc. R. Co. (1883), 17 S. C. 219 ; s. c. 12 Am. & Eng. R. R. Cas. 495.

[2] Galena, etc. R. Co. *v.* Barrett (1880), 95 Ill. 467.

CHAPTER IV.

GUARANTY OF BONDS.

§ 80. **Introductory.** — The fundamental rule upon which the enforceability of contracts of guaranty depends has been thus enunciated in an English treatise of high authority: "It is no part of the ordinary business of commercial, and *a fortiori* still less so of non-commercial, corporations to become security for others. Under ordinary circumstances, without positive authority in this behalf in the constating instruments, all engagements of this description are *ultra vires*, whether they take the direct form of suretyship or the indirect forms of joining in accommodation bills, or otherwise becoming liable for the debts of others, or the still more indirect form of guaranteeing profits or expenses, or otherwise assisting the business of others, or in the development thereof, or obtaining further powers therefor. Therefore, there ought properly to be an express power to this effect."[1] This

[1] Brice's Ultra Vires (Green's Am. ed., 1880), p. 252. The decisions in this chapter are not limited to cases involving railway bonds, but include some others as illustrative of the principles applicable to guaranty of railway bonds. See note in 26 Am. & Eng. R. R. Cas., 105, on guaranty of bonds of another company.

would seem, however, to be a more rigorous statement of the rule than is justified either by the principles on which the rule is founded, or the cases in which those principles have been applied. There is no question but that the courts have fully recognized the doctrine that corporate officers have, under various circumstances, implied authority to bind the corporation by a guaranty. In fact it is only in a few of the States that the legislature has made any express provision for this contract by general laws, and the litigation on the subject[1] indicates that it is rarely, if ever, regulated by provisions either in special charters or in by-laws. The actual task of the courts, therefore, has been to determine when such authority is implied.

While it is difficult to frame a rule which shall be sufficiently definite to furnish a key to the solution of all the manifold problems arising in connection with this subject, the cases at all events show that, provided the transaction of which the guaranty is a part is not *ultra vires*, and the guaranty is sustained by a sufficient consideration, the proper officers of the corporation may bind it by guarantying the obligation of other corporations or of individuals, wherever the guaranty will render the transaction more beneficial to the corporation on behalf of which it is executed, either by saving it from loss or securing some direct benefit. The preliminary question, then, in every case is, whether the transaction in which the guaranty was given was wholly beyond or within the powers of the corporation. If it was beyond those powers, this excess of authority necessarily vitiates the guaranty, this being the result, according to the weight of authority, whether the stockholders have ratified it or not (see §§ 85, 88, *infra*). On the other hand, if the transaction was not *ultra vires* in this absolute sense, the binding character of any guaranty which the corporate officers may have executed while engaged in carrying it through, depends, at least where the peculiar policy of the law in regard to commercial paper does not qualify the rights of the parties, upon the ordinary considerations which determine the validity of the acts of such officers. If it was reasonably appropriate for the purpose of securing the benefits of the transaction for the shareholders, there seems to be no reason why it should not be enforced against them by any one who has not actual notice of a defect of authority. The proper way, therefore, to determine whether the guaranty is valid is to regard it, not as a separate transaction, but as a part of a larger transaction. It is submitted that there is nothing in the cases at variance with

[1] See notes to § 93, below.

this theory, so far as the actual decisions are concerned; though it must be conceded that the courts have in the majority of instances argued as though a corporate guaranty was something distinct, which must stand or fall on its own merits. This has been a source of needless difficulties, if not of actual errors. A review of the cases cited below shows they have really turned upon two questions: First, whether the transaction on which the guaranty was given was within the corporate powers; and, second, whether, supposing the transaction to be of that character, the circumstances were such as would have warranted the directors in undertaking to place the corporation in the position of a principal obligor, for the performance of some act which was to constitute the consideration for the benefit anticipated from the transaction. Or more briefly still, it may be said that the only point to be decided is, whether the case is one in which the directors can render the corporation directly liable. If it is such a case, they can clearly impose upon it the secondary liability of a guarantor. If it is not such a case, their inability to charge it with this secondary liability is equally manifest.

The directors of a railroad company, being trustees and representatives charged with the exercise of all the powers of the corporation, which do not involve fundamental changes in the purposes of the incorporators, under a power given the company to guaranty bonds of another company which may prove a feeder to its business, may make such guaranty without the assent of the stockholders.[1]

[1] Louisville Trust Co. *et al.* *v.* Louisville N. A. & Chicago R. Co. (1896), 75 Fed. Rep. 433, reversing Louisville N. A. & Chicago R. Co. *v.* Ohio Valley Improvement & Contract Co. *et al.* (1894), 69 Fed. Rep. 431.

A railroad company incorporated in Indiana was made a corporation by the legislature of Kentucky. As a Kentucky corporation the legislature granted it authority to indorse or guaranty the principal and interest of the bonds of any railway company then constructed or to be thereafter constructed within the limits of the State of Kentucky, and to consolidate its rights, franchises, and privileges with any railway company authorized to construct a railroad from the city of Louisville to any point on the Virginia line, such indorsement, guaranty, or consolidation to be made upon such terms and conditions as might be agreed upon between the companies. The company leased a road, and one to be constructed in the State would continue the leased road toward the line of Virginia. The lessor company guarantied the bonds of the company whose road was to be constructed, to be delivered to the contractors for its construction, and received stock of the company for the guaranty. The U. S. Circuit Court of Appeals for the Sixth Circuit held that, under the powers granted by the Kentucky legislature, the company was authorized to make the guaranty of bonds and to acquire the stock of the other company; that the guaranty was binding on it and enforceable against its property in Kentucky, notwithstanding the fact that, as an Indiana corporation, it may not have had granted to it such power.

§ 81. **A Contract of Guaranty creates Independent Rights and Liabilities.** — For this reason the guarantor of bonds cannot, in an action on his guaranty, escape liability on the ground that the bonds are void.[1] On the other hand, where the mortgage expressly provides that entry by the trustees, upon default in the payment of interest, shall not deprive them or any other parties of their full rights and remedies, a bondholder who has taken no part in proceedings by the trustees to obtain possession may bring an action to enforce a guaranty indorsed on the bonds by another company.[2]

One accepting the guaranty of one railroad company of the bonds of another will be charged with notice of a statute of the State of its creation which requires a petition of its stockholders for such a guaranty to be filed before its board of directors, and if he knows such a petition of stockholders was not filed with the board, cannot hold the guarantor to any liability on the guaranty.[3]

The negotiability of the guaranty of such bonds is not affected by such statutes as that of Kentucky (Gen. St., c. 22, §§ 6, 13, 14), with respect to the negotiability and assignability of bonds and promissory notes, as they have no application to bonds like railroad bonds payable to bearer. They apply only when an assignment is necessary to pass the title to the *chose in action*.[4]

Though a statute empowering a railroad company to guaranty the bonds of another may require a petition to that effect from the stockholders to the board of directors, if such a guaranty is directed by the board without such a petition, the guaranty is not, as *ultra vires* the company, absolutely void. It may be ratified, and one purchasing such guaranty without notice of the failure to petition will be entitled to enforce the same against the guarantor.[5]

Bonds issued by corporations or joint-stock companies, and

[1] Connecticut Mutual Life Ins. Co. *v.* Cleveland, Columbus, & Cincinnati R. Co. (1863), 41 Barb. 9.

[2] Racey *v.* Erie Ry. Co. (1881), 12 N. Y. Weekly Dig. 457 ; s. c. 24 Hun, 342.

[3] Louisville Trust Co. *et al.* *v.* Louisville, N. A. & Chicago R. Co. (1896), 75 Fed. Rep. 433, 450.

[4] Louisville Trust Co. *v.* Louisville, N. A. & Chicago R. Co. *et al.* (1896), 75 Fed. Rep. 433, 458.

[5] Louisville Trust Co. *et al.* *v.* Louisville, N. A. & Chicago R. Co. (1896), 75 Fed. Rep. 433, reversing Louisville, N. A. & Chicago R. Co. *v.* Ohio Valley Improvement & Contract Co. *et al.* (1894), 69 Fed. Rep. 431, in which case the court sustained an injunction against the bondholders and decreed a cancellation of the guaranty. There is upon this point an elaborate argument and a very full reference to the cases pertinent to the subject in the opinion of the U. S. Circuit Court of Appeals in Louisville Trust Co. *et al.* *v.* Louisville, N. A. & Chicago R. Co., *supra.*

made negotiable by the Pub. Sts. Mass., c. 77, § 4, and the holder of such bonds, although not the person to whom they were originally delivered, and though no consideration moved from him to the corporation, may maintain an action upon them in his own name.[1]

§ 82. **Guaranty for Accommodation not valid.** — It is well settled that no corporate agent has implied authority to give away any portion of the corporate property, or to create a corporate obligation gratuitously. From this principle it follows that the assumption of the position of surety for a liability in which the corporation has no direct interest is undeniably a transaction which is outside the scope of its business, and that the corporate officers of the corporation have no implied power to place it in such a position by making an accommodation indorsement.

The cases in which this rule is qualified by circumstances amounting to a ratification on the part of the corporation, or by the special principles protecting innocent purchasers of negotiable paper, are noticed below, §§ 88, 91.

§ 83. **What is generally a Sufficient Consideration.** — Where the contract of guaranty is indorsed on the bonds before their issue and delivery by the obligor company, the credit given to the latter is a sufficient consideration to support the contract of guaranty. But if the guaranty is given after the execution and delivery of the bonds, the contract is not binding on the guarantor unless he receives some separate consideration for the guaranty.[2]

A guarantor who inserts the words "value received" in his guaranty is not a mere accommodation indorser, as this expression imports a sufficient consideration.[3]

In the leading case of Railroad Co. *v.* Howard[4] it was held that, as railroad companies have power to issue their own bonds to construct their roads, they have also power to guaranty the bonds of cities and counties which have been lawfully issued, and are sold instead of their own, as the means of accomplishing the same end. Being entitled to receive such bonds, they may transfer them to others; and having the capacity to make such transfer, they may, if they deem it expedient, guaranty their payment for

[1] Strauss *v.* United Telegram Co., 164 Mass. 130; s. c. 41 N. E. Rep. (1895). See Carr *v.* LeFevre (1856), 27 Pa. St. 413, 418; Bunting *v.* Camden & Atlantic Railroad (1876), 81 Pa. St. 254; Society for Savings *v.* New London (1860), 29 Conn. 174.

[2] Toppan *v.* Cleveland, Columbus, & Cincinnati R. Co. (1860), 1 Flip. 74.

[3] Connecticut Mutual Life Ins. Co. *v.* Cleveland, Columbus, & Cincinnati R. Co. (1863), 41 Barb. 9.

[4] 7 Wall. 392 (1868), followed in Arnot *v.* Erie Ry. Co. (1876), 67 N. Y. 35. See §§ 86 *a*, 91.

the purpose of augmenting their credit in the market. So, also, under a general authority to issue bonds for construction purposes, a lessor company may lawfully guaranty the payment of notes issued for that purpose by the trustees and managers appointed in proceedings to enforce a mortgage upon all the property of a company to which the guarantor has leased its road in perpetuity.[1]

§ 84. **Guaranty given as Part of the Consideration of a Lease is valid.** — Authority to accept a lease of another road necessarily implies authority to arrange for paying rent, and one of the ways in which such payment may legitimately be effected is by paying the coupons of the lessor's bonds, or guarantying their payment.[2]

So, also, a statute providing that railroad corporations may lease their roads to other corporations, and "shall be capable in law to make all contracts . . . necessary for the construction, completion, and maintenance of its road, . . . and generally to possess all the powers and privileges for the purpose of carrying on the business of the corporation, that private individuals and natural persons now enjoy," has been held to entitle such a corporation to guaranty the bonds of a company whose line it has leased.[3]

[1] Codman *v.* Vermont & Canada R. Co. (1879), 16 Blatch. 165.

[2] Eastern Township Bank *v.* St. Johnsbury & L. C. R. Co. (1889), 40 Fed. Rep. 423.

[3] Low *v.* Central Pac. R. Co. (1877), 52 Cal. 53; s. c. 9 Am. Ry. Rep. 366. The majority of the court proceeded upon the ground that it was competent for the lessee company to contract to pay *as rent* an amount equal to the amount of the lessor's bonds, and that this involved the proposition that the company might, upon a sufficient consideration, guaranty such bonds, the power to make an absolute promise of payment necessarily embracing the power to make a conditional promise of payment. Stress was also laid on the fact that the statute placed the company on the same footing as private persons in regard to contracts. The latter reason is possibly open to the objection noticed by Judge McKinstry in his dissenting opinion, viz., that as the clause conferring this freedom of contract followed an enumeration of certain powers specifically conferred, it was merely declaratory of the rule that powers incidental to the powers expressly conferred may be exercised by a corporation. But the former reason is quite sufficient to justify the ruling in view of the fact that the court was not called upon to determine whether the contract was one which the corporators might have objected to on the ground of its improvidence, but whether, when those corporators were satisfied with the arrangement, it was competent for one who had agreed to take the bonds to refuse to fulfil his contract on the ground that the guaranty was void as being absolutely *ultra vires*. It is to be regretted that the court has somewhat weakened the authority of the decision, and provoked criticism by opening up the subject of the implied powers of corporations, instead of planting itself firmly on the absurdity of maintaining that the debt of a corporation may be acknowledged directly by its own notes, and not indirectly by the assumption of a secondary liability on the obligations of other parties. It is undoubtedly one of the numerous cases in which the unfortunate ambiguity of the term *ultra vires* has produced a mischievous confusion of thought.

§ 85. **Guaranty to save Corporation from Actual Financial Embarrassment is valid.** — The assumption of a third person's debt is within the scope of the powers of the directors of a corporation when such assumption is urgently required for the purpose of saving the credit of the corporation and enabling it to go along with its business.[1]

§ 86. **Guaranty of Obligations of Companies carrying on another Business, how far valid.**[2] — (a) *Cases in which the Power has been denied.* — The well-settled doctrine, that a company incorporated for a special purpose cannot devote any part of its funds to objects unauthorized by its charter, however desirable such an application may appear to be, involves the corollary that any guaranty is invalid which is essentially an undertaking that a corporation, partnership, or individual shall be indemnified against loss, or receive certain profits in the conduct of a business which the guarantor itself is not authorized to engage in. The State which confers the franchise of a corporation, as well as the stockholders who have invested their money in the enterprise, and the creditors who have advanced their money on the faith of it, have a right to assume that no such diversion of the corporate funds shall be made.[3]

Thus a railroad company cannot guaranty that the subscribers to the stock of an elevator company shall receive a certain percentage of dividends, though it may undoubtedly build or rent elevators for the purpose of facilitating the conduct of its own business.[4]

The mere ground that conjectural or speculative benefits were believed by the corporate officers to be likely to result from the guaranty, and that the other party has incurred expenses on the faith of it, will not render the contract enforceable. Since, therefore, the holding of a "World's Peace Jubilee and International Musical Festival" is an enterprise wholly outside the objects for

[1] Stark Bank *v.* U. S. Pottery Co. (1860), 34 Vt. 144.

[2] Louisiana State Bank *v.* Orleans Navigation Co. (1848), 3 La. Ann. 294; National Park Bank *v.* German-American Warehousing, etc. Co. (1889), 116 N. Y. 281; s. c. 26 N. Y. St. Rep. 675; 22 N. E. Rep. 567; Wahlig *v.* Standard Pump Manufg. Co. (1889), 5 N. Y. Suppl. 420; s. c. 25 N. Y. St. Rep. 864; Mather *v.* Union Loan & Trust Co. (1889), 7 N. Y. Suppl. 213; s. c. 26 N. Y. St. Rep. 58; Usher *v.* Raymond Skate Co. (1895), 163 Mass. 1; s. c. 39 N. E. Rep. 416; Humboldt Mining Co. *v.* American Manufacturing, Mining, & Milling Co. (1894), 62 Fed. Rep. 356; National Bank of Gloversville *v.* Wells (1880), 79 N. Y. 498.

[3] Marbury *v.* Kentucky Union Land Co. (1894), 62 Fed. Rep. 335; 10 C. C. A. 393, and cases cited, affirming Tod *v.* Kentucky Union Land Co. (1893), 57 Fed. Rep. 47.

[4] Elevator Co. *v.* Memphis & Charleston R. Co. (1887), 85 Tenn. 703; s. c. 5 S. W. Rep. 52.

which railroad and manufacturing companies are established, a guaranty of the expenses of such a festival, although it will have a favorable effect on the profits of both companies, in the one case by increasing the passenger travel, and in the other by creating a more active demand for the articles manufactured, has been held to be *ultra vires* the corporation.[1]

So, also, a guaranty by the secretary of a transportation company that a brewing company shall be paid for all the beer purchased by one of its customers is *ultra vires* against the shareholders at least, if not absolutely so.[2]

Similarly it has been held that a guaranty of a loan made to another for the purpose of constructing a connecting road, expected to be advantageous to the guarantor, was unauthorized, and that, if the guarantor discharged the loan, it could not hold the second company liable for the money.[3]

So, also, it is an excess of power for a company organized to manufacture ironwork for mines, to guaranty the performance of another's contract, although the object of the guaranty is to secure a customer.[4]

According to a recent English case, contracts of this description are *ultra vires*, not merely of the corporate officers, but of the corporation itself, and therefore incapable of ratification even by the whole body of shareholders.[5]

This principle has been accepted by at least two courts of the highest authority in this country.[6]

[1] Davis *v.* Old Colony Railroad (1881), 131 Mass. 258. An agreement by which the E. Company agreed to make good any deficiencies of the interest on the bonds of the T. Company, the consideration being that the T. Company should deliver to the E. Company all the freight which it could control, and that the T. Company should use its influence, so far as it could with proper regard to its own interests, to promote the business of the E. Company, has been held to contain nothing obnoxious to the laws of New York. Tonawanda Valley & Cuba R. Co. *v.* New York, Lake Erie, & West. R. Co. (1886), 4 N. Y. St. Rep. 744; s. c. 42 Hun, 496; Bradford, Eldred, & Cuba R. Co. *v.* New York, L. E. & Western R. Co. (1888), 28 N. Y. St. Rep'r, 208; s. c. 48 Hun, 621. In the last case Daniels, J., dissented on the ground that such a contract was *ultra vires*, the ground of decision by the majority of the court in both cases being apparently that the contract was not contrary to the policy of the statutes of the State.

[2] Lucas *v.* White Line Transfer Co. (1886), 70 Iowa, 541; s. c. 30 N. W. Rep. 771.

[3] Madison, etc. Plank Road Co. *v.* Watertown, etc. Plank Road Co. (1859), 7 Wis. 59.

[4] Humboldt Mining Co. *v.* Variety Iron Works Co. (1894), 62 Fed. Rep. 356; s. c. 10 C. C. A. 415.

[5] Ashbury Ry. Carriage & Iron Co. *v.* Riche, L. R. 7 H. L. 653.

[6] Thomas *v.* Railroad Co. (1879), 101 U. S. 71; Davis *v.* Old Colony Railroad (1881), 131 Mass. 258. In Lucas *v.* White Line Transfer Co. (1886), 70 Iowa, 541; s. c. 30 N. W. Rep. 771, the court left the point undecided, but said that at all events the ratification would be ineffectual unless the assent of all the shareholders was obtained. In Indiana an

A less rigid rule perhaps prevails in other jurisdictions. Thus it has been held in New York that when the officers of a corporation engage in an *ultra vires* business for the benefit of the corporation, and when the business is so carried on with the acquiescence of the stockholders that it actually, although illegally, becomes the business of the corporation, it cannot maintain an action against such officers for any damages it has suffered in the business.[1]

So it has been held that a lumber company may guaranty railroad bonds issued to construct a road penetrating the country from which the timber for such lumber company is to be drawn, and essential to the successful prosecution of its business, where the express consent of the stockholders and directors is given thereto.[2]

Supposing the former doctrine to be the true one, the question presents itself, whether, in case the guaranty should take the shape of an indorsement of the negotiable securities of the company to whom the guaranty is given, a *bona fide* holder would be able to recover on the guaranty. The conclusion that he would not seems to be warranted by the rulings which deny such a holder the right to recover on bonds issued for an entirely unauthorized purpose (see Chap. II.), for the principle is clearly recognized that the power to issue bonds is coextensive with the power

acceptance of paper for an unauthorized purpose by a railroad company apparently raises no legal liability even in favor of an innocent holder · Smead *v.* Indianapolis, Pittsburg, & Cleveland R. Co. (1858), 11 Ind. 104; though the court held that under the special provisions of the company's charter the guaranty was valid.

[1] Holmes, Booth, & Haydens *v.* Willard (1890), 125 N. Y. 75; s. c. 25 N. E. Rep. 1083. It is, however, worthy of note that (1) the action here was not by a third party against the corporation on an executory contract, like the cases cited above, and that it was virtually an attempt by one set of wrongdoers to recover damages from another set who had participated in the same wrong; and (2) that, apart from this special ground for the decision, one of the authorities relied on as to the possibility of the stockholders ratifying an illegal contract was the decision in a lower court to that effect in the Ashbury Railway Carriage, etc. Co. case, *supra*, which was overruled by the House of Lords.

[2] Mercantile Trust Co. *v.* Kiser *et al.* (1893), 91 Ga. 636; s. c. 18 S. E. 358. In Cozart *v.* Georgia Railroad & Bkg. Co. (1875), 54 Ga. 379, the court assumed that an arrangement embracing a joint guaranty of the bonds of another company for the purpose of sharing in the advantages of the control obtained by the other guarantor over the management of the company which had issued the bonds, was only *ultra vires* as against the stockholders of the guarantor companies.

In Macon & Augusta R. Co. *v.* Georgia Railroad & Bkg. Co. (1879), 63 Ga. 103, the court referred to the fact of there being no statute to legalize the guaranty by the defendant; but it is evident that it was not intended to lay down the rule that a statute is necessary for that purpose where innocent purchasers are suing on the guaranty. The actual ground of decision in both cases was that parties who might have objected successfully to the guaranty had by acquiescence lost their right to do so.

to guaranty them.[1] But no direct decision on the point has, so far as is known, been rendered.[2]

(b) *Cases in which the Power has been conceded.*—The principles on which the above cases were decided will be more clearly realized by considering the decisions in which the power of a corporation to assist other parties in their business has been sustained. It is evident, in the first place, that a guaranty must be valid if it was executed to further a transaction which the corporation was competent to carry through as principal. Thus a railroad company empowered to build, construct, and run, as a part of their corporate property, such number of steamboats or vessels as they may deem necessary to facilitate its business operations, has, by implication, the power to employ steamboats belonging to others, in connection with its own business, under an agreement by which it guaranties to the proprietors of the boats that their gross earnings shall not fall below a certain sum. The ground of the decision was that the power to secure steamboat connection by the guaranty was of the same character as that of owning and running a steamboat, and involved less responsibility and risk of loss on the part of the railroad company.[3]

An analogous principle is illustrated in those cases where the power of one corporation to guaranty the obligations of another has been inferred from a statutory authority to assist it by direct contributions, or to participate in the enterprise to be promoted. Thus a company authorized to aid another company in constructing its road "by means of subscription to its capital stock or otherwise," for the purpose of forming a connection with the road of the company furnishing the aid, may guaranty the bonds of such other company, as a part of an arrangement for aiding it.[4]

Sufficient consideration for a guaranty in such a case exists,

[1] Railroad Co. *v.* Howard (1868), 7 Wall. 392.

[2] See, however, Smead *v.* Indianapolis, Pittsburg, & Cleveland R. Co. (1858), 11 Ind. 104, referred to, *supra*, a case involving an acceptance of a bill.

[3] Green Bay & Minnesota R. Co. *v.* Union Steamboat Co. (1882), 107 U. S. 98. A corporation dealing in manufactured goods, and needing them for sale, may, as a proper incident to its business, extend financial aid to a manufacturer by advancing him money to enable him to furnish the goods, and that this aid may be extended by a loan of its own money, or take his notes and by its credit raising money thereon, looking for reimbursement out of the goods to be manufactured and delivered to it. Holmes, Booth, & Haydens *v.* Willard (1890), 125 N. Y. 75; s. c. 25 N. E. Rep. 1083. By the laws of New York manufacturing companies may hold stock in corporations engaged in supplying such materials as are required in the prosecution of their business. N. Y. L. 1848, ch. 40, § 4.

[4] Connecticut Mut. Life Ins. Co. *v.* Cleveland, Columbus, & Cincinnati R. Co. (1863), 41 Barb. 9.

where it is a part of an arrangement between the guarantor and other companies for the purpose of securing a uniform gauge on their connecting roads and thus securing an increase of profits.[1]

So the fact that a railroad company holds stock in another, and that the latter road, when constructed, will become a feeder to the former line, is a sufficient consideration for the guaranty by the former of bonds issued by the latter to aid in the construction of the road.[2]

Similarly the power of one company to guaranty the bonds of another is necessarily implied where the charter of the former authorizes it to effect a temporary or permanent consolidation with the latter, since this virtually amounts to a permission to risk its whole capital in another business.[3]

Some courts have shown a disposition to extend the operation of these principles further than is perhaps warrantable. Thus it has been held that a guaranty by a brewing company of a lease of premises occupied by one of its customers is not *ultra vires*.[4]

But this doctrine is, to some extent, inconsistent with an earlier decision by the same court to the effect that a brewing company cannot guaranty the payment of rent by a hotel-keeper, the ordinary rule being applied, that the fact of the guarantor's expecting to reap some profit from the arrangement did not give the company that direct interest in the contract which alone could justify such an undertaking.[5]

Finally it is evident that there is no reason why a corporate

[1] Connecticut Mut. Life Ins. Co. *v.* Cleveland, Columbus, & Cincinnati R. Co. (1863), 41 Barb. 9. Somewhat similar in principle is Smead *v.* Indianapolis, Pittsburg, & Cleveland R. Co. (1858), 11 Ind. 104, where a railroad company empowered to make such contracts with a company owning a connecting road for the transportation of freight and passengers, and for the use of its road, as the board of directors might think proper, was held to have power to give its bills and notes to the second company, to enable it to change the gauge of its road.

[2] Harrison *v.* Union Pac. Ry. Co. (1882), 13 Fed. Rep. 522.

[3] Marbury *v.* Kentucky Union Land Co. (1894), 62 Fed. Rep. 335; s. c. 10 C. C. A. 393, containing an elaborate review of cases, affirming Tod *v.* Kentucky Union Land Co. (1893), 57 Fed. Rep. 47.

[4] Fuld *v.* Burr Brewing Co. (N. Y. Supr. Ct., 1892), 18 N. Y. Supp. 456. No reasons are given for its opinion by the court, which is possibly based on the fact that it is customary for brewers to set up saloon-keepers in business by advancing money to them, or guarantying the payment of their liabilities. If so, the decision may perhaps be justified on the ground that the guaranty, under the peculiar circumstances of the case, was given to protect the guarantor's loan.

[5] Filon *v.* Miller Brewing Co. (N. Y. Supr. Ct., 1891), 60 Hun, 582; s. c. 15 N. Y. Supp. 57. In Ridley *v.* Plymouth, etc. Baking Co. (1848), 2 Exch. 711, the court seems to have assumed that a contract to indemnify a sub-tenant against the payment of any of the head rent was *ultra vires*, as the discussion was confined to the question whether the contract made by the directors was invalid for the reason that it was not under seal.

guaranty designed to enhance the credit of another company should not be regarded as within the power of the directors, where it takes the shape of a guaranty of debentures of the second company assigned to the guarantor in liquidation of a debt. The exercise of such a power is justifiable on the principle that, having lawfully become vested with the ownership of the debentures, they are entitled to dispose of them to the best advantage.[1]

§ 86 *a*. **Guaranty valid where it forms Part of a Compromise Arrangement with a Debtor of the Guarantor.** — It has been suggested *obiter* in an English case by Lord Campbell that a contract by directors to indemnify a debtor on certain obligations might possibly be upheld as a reasonable part of a compromise arrangement.[2]

This suggestion enunciates a principle which has been recognized in some cases. A guaranty of the bonds of another company which a person having a valid claim against the guarantor agrees to accept in discharge of such claim is a lawful transaction. The company having the option of paying the claim in anything that has a money value may obviously impart additional value to the *choses in action* of another obligor by making itself responsible for their payment. In such a case it is of no importance whether the guaranty, when originally executed, was *ultra vires* or not, for the transfer of the bonds with the guaranty upon them to a creditor amounts to a renewal of the guaranty upon a sufficient consideration then passing between the parties. The transferee takes the guaranty as part of the purchase, although it is not mentioned, the failure to express the true consideration being immaterial, since that is always open to explanation and variation by parol.[3]

So also bonds of one company transferred to another in payment of a debt owed by the obligor may be guarantied by the trans-

[1] In *Re* West of England Bank (1880), 14 Ch. Div. 317, Vice-Chancellor Malins laid a good deal of stress on the extensive character of the powers bestowed on the directors; but this reasoning is in other respects of a general description, and indicates clearly that the distinction present to his mind was that which exists between engaging in an entirely different business and augmenting the credit of one of the company's debtors by giving currency to the obligations of the latter. To the same effect see Marbury *v.* Kentucky Union Land Co. (1894), 62 Fed. Rep. 335; 10 C. C. A. 393. See §§ 83, 87.

[2] Kirk *v.* Bell (1851), 16 Ad. & E. (N. S.) 290.

[3] Arnot *v.* Erie Ry. Co. (1876), 67 N. Y. 315; s. c. 15 Am. Ry. Rep. 133. Judge Earl remarked that the transaction might be treated as if the company had said to its creditor, "Here are our bonds and here is our guaranty, take them in satisfaction of your claims." The case was followed in Atchison, etc. R. Co. *v.* Fletcher (1886), 35 Kan. 236; 24 A. & E. 234. See also §§ 83, 91.

feree as a means of augmenting the credit of the bonds, and thus enabling the guarantor to obtain an adequate price from a purchaser.[1]

§ 87. **Guaranty of Bonds owned by the Corporation is valid.** — The power of a corporation to indorse the written obligations of others, which it holds as owner, with a view to raising money on them, is as complete as that of an individual.[2]

Hence a guaranty of the bonds of another corporation is valid, when such bonds have been taken by the guarantor in payment of a debt due to it.[3]

§ 88. **Guaranty may be validated by Ratification, where not absolutely ultra vires.** — The rule that, where a transaction is *ultra vires* merely as between the directors and the corporators, the latter may be estopped from repudiating it, either by express ratification or by such acquiescence and an enjoyment of its fruits that to permit it to be set aside would constitute a fraud, applies to an indorsement by one company of another's bonds.[4]

Thus where the proper officers of a corporation have negotiated a bill to an indorsee, representing it to belong to the corporation, and upon the faith of that representation the indorsee has discounted it in the usual course of business, advancing the proceeds to the corporation, the latter is precluded from setting up that it was indorsed without authority.[5]

So an accommodation indorsement will create a liability against the corporation if the stockholders assent to it.[6]

[1] Rogers Locomotive & Machine Works *v.* Southern Railroad Association (1888), 34 Fed. Rep. 278.

[2] Bank of Genesee *v.* Patchin Bank (1855), 13 N. Y. 309; Madison, etc. R. Co. *v.* Norwich Sav. Soc. (1865), 24 Ind. 457. Compare Bonner *v.* City of New Orleans, 2 Woods, 135, where a railroad company, having transferred by indorsement a negotiable bond issued by a municipal corporation to the company as payee, was held bound as indorser, upon the default of the municipal corporation. See also Olcott *v.* Tioga R. Co., 27 N. Y. 546.

[3] Marbury *v.* Kentucky Union Land Co. (1894), 62 Fed. Rep. 335; s. c. 10 C. C. A. 393; *In re* West of England Bank (1880), 14 Ch. Div. 317. See also §§ 85, 86 *a*.

[4] Cozart *v.* Georgia Railroad & Bkg. Co. (1875), 54 Ga. 379; Macon & Augusta R. Co. *v.* Georgia Railroad & Bkg. Co. (1869), 63 Ga. 103.

[5] Bank of Genesee *v.* Patchin Bank (1855), 13 N. Y. 309; s. p. Central Bank *v.* Empire Stone Dressing Co. (1858), 26 Barb. 23. An allegation that the defendant has caused a representation to be indorsed on the bonds of another company to the effect that the payment of the interest of those bonds is guarantied by the defendant for a specific period, sets forth a good cause of action, inasmuch as proof of the fact alleged will make the defendant liable for the interest. Opdyke *v.* Pacific R. Co. (1874), 3 Dill. 55.

[6] Martin *v.* Niagara Falls Paper Mfg. Co., 122 N. Y. 165; s. c. 25 N. E. Rep. 303, affirming Martin *v.* Niagara Falls Paper Mfg. Co. (1887), 44 Hun, 130.

A court will be very slow to set aside a contract of guaranty as being *ultra vires*, in the sense of not being beneficial to the corporations, where stockholders, at the time it was executed, with the information they then possessed, considered it to be beneficial.[1]

§ 89. **Negotiability of Guaranty.** — A general guaranty indorsed by one company upon the bonds of another at the time of their issue is negotiable like the bonds themselves.[2]

But it is otherwise with what is on its face a purely collateral guaranty given as a part of the consideration of a contract subsequent to the issue of the bonds, as where a lessee guaranties the interest on the bonds of a lessor.[3]

§ 90. **Guaranty not invalidated as to Innocent Purchasers by the Omission of merely Directory Formalities.** — The principle that a corporation acting within the range of its general authority, but failing to comply with some formality or regulation which should have been observed, is precluded from setting up its neglect, with a view to defeat the rights of the parties with whom it has been dealing, operates so as to prevent a stockholder of a guarantor company from obtaining an injunction against the payment of interest on the bonds guarantied by it, after the bonds have been sold to innocent purchasers on the faith of representations that the legal prerequisites to the execution of the guaranty have been duly complied with.[4]

A bondholder suing a guarantor company on its guaranty is not bound to aver that the guaranty was given agreeably to the provisions prescribed by the enabling statute in regard to obtaining the assent of the stockholders, the presumption being that the

[1] Marbury *v.* Kentucky Union Land Co. (1894), 62 Fed. Rep. 335; s. c. 10 C. C. A. 393, affirming Tod *v.* Kentucky Union Land Co. (1893), 57 Fed. Rep. 47.

[2] Toppan *v.* Cleveland, Col. & Cinc. R. Co. (1862), 1 Flip. 74. A guarantor company is liable on its guaranty for the principal when the bonds become due by the terms of the mortgage on account of default in payment of interest, and they are declared due by the trustee. Dougan *v.* Evansville & T. H. R. Co., 15 App. Div. 483; s. c. 44 N. Y. Supp. 503. The Supreme Court of Ohio held in Bank of Ashland *v.* Jones *et al.* (1865), 16 Ohio St. 145, that a guaranty of the bonds of a company by its directors to make them salable would pass as an incident of the bonds, and, in equity, could be enforced by a subsequent purchaser of the bonds. In the Appellate Division of the Supreme Court of New York, 1st Dept., the court held that coupons severed from bonds which had been guarantied became independent obligations, and were not within the guaranty of the principal and interest on these bonds. Clokey *v.* Evansville & T. H. R. Co. (1897), 44 N. Y. Supp. 631. O'Brien, J., dissented.

[3] Eastern Township Bank *v.* Johnsbury & S. C. R. Co. (1889), 40 Fed. Rep. 423. In this case the guaranty was not by its terms made negotiable, and under the statute of Vermont it was not made so.

[4] Zabriskie *v.* Cleveland, Columbus, & Cincinnati R. Co. (1859), 23 How. 381.

defendant in executing the guaranty has complied with all legal requirements and regulations.[1]

§ 91. **Improper Exercise of Power of Guaranty, Rights of Innocent Purchaser not impaired by.** — A stockholder in a company which has executed a guaranty under the provisions of a statute empowering it to guaranty the bonds of another company "whose road is being constructed to connect with its own," cannot, after the bonds have passed into the hands of *bona fide* purchasers, maintain a suit to cancel them on the ground that there was no actual connection between the roads at the time the guaranty was executed.[2]

So also a corporation is bound by the act of its officer in affixing its signature to accommodation paper, when such paper has passed into the hands of an innocent holder.[3]

In determining the rights of a *bona fide* purchaser of guarantied bonds, the guaranty will be treated as if written at the time of the purchase, where there is nothing to show that the guaranty did not pass as a part of the consideration.[4]

§ 92. **Rights of Guarantor of Interest when postponed to those of Bondholders.** — A company which has guarantied the interest on

[1] Toppan *v.* Cleveland, Columbus, & Cincinnati R. Co. (1862), 1 Flip. 74; Connecticut Mut. Life Ins. Co. *v.* Cleveland, Columbus, & Cincinnati R. Co. (1863), 41 Barb. 9.

[2] Atchison, Topeka, & Santa Fé R. Co. *v.* Fletcher (1880), 35 Kan. 236; s. c. 24 Am. & Eng. R. R. Cas. 234; 10 Pac. Rep. 596.

[3] Bank of Genesee *v.* Patchin Bank (1855), 13 N. Y. 309; s. p. Bridgeport City Bank *v.* Empire Stone Dressing Co. (1859), 30 Barb. 421; Madison, etc. R. Co. *v.* Norwich Sav. Soc. (1865), 24 Ind. 457. In the last-mentioned case the guarantied bonds were made payable by the company which issued them to the company which guarantied them. The assignment with the guaranty, therefore, amounted to a representation that the assignor was the owner of the bonds. The court said that a different question would have been presented if the bonds had been payable to bearer, as that would have implied little or nothing as to the fact of ownership by the guarantor, and would have had but a slight tendency to mislead as to a circumstance on the existence of which the power to make the guaranty depended. Granting that every person taking the bonds was bound to take notice of the limits of the powers of the company which guarantied them, the question whether they had been received by the company in the course of its lawful business, or whether the company had no ownership or interest in them, was a question of fact, and not of law. To hold that the purchaser in such a case was obliged at his peril to ascertain these extrinsic facts was a doctrine utterly at variance with the settled principle of law relating to commercial paper; viz., that the general agent of a corporation, clothed with a certain power by the charter, or by the lawful act of the corporation, may use that power for an unauthorized, or even a prohibited purpose, in his dealings with an innocent third party, and yet render the corporation liable for his acts. Smead *v.* Indianapolis, etc. R. Co., 11 Ind. 104, was overruled as to the distinction there taken between paper executed beyond the corporate power, and that executed within that power, but by an abuse of it in the particular instance. Compare on this subject Chap. II., § 55, *ante.*

[4] Rogers Locomotive & Machine Works *v.* Southern Railroad Association (1888), 34 Fed. Rep. 278, citing Arnot *v.* Erie Ry. Co. (1876), 67 N. Y. 315; s. c. 15 Am. Ry. Rep. 133. See also §§ 83, 86 *a.*

the bonds of another company, and, in pursuance of the contract, taken up maturing coupons, cannot, as against the holders of the bonds, assert a right to share *pro rata* in the allotment of stock in a new company organized by those bondholders. When the bondholders receive the amount of the coupons, they have a right to regard it as payment and extinguishment of the interest which diminishes the amount of their debt and strengthens their security. To allow the guarantors under such circumstances to be subrogated to the rights of the bondholders in regard to the coupons, whether detached or not, would violate the spirit of the contract of guaranty.[1] (Compare Chap. II., § 37.)

§ 93. **State-indorsed Bonds are subject to Constitutional Limitations in Force when Guaranty Act was passed.** — After the obligation of a State to guaranty the bonds of a railroad company has lapsed through the non-performance within the time limited of the acts which were to have entitled the company to such guaranty, it can only be renewed subject to such constitutional provisions as may have been adopted since it was first offered to the company.[2]

And if the legislature could not create a debt when the bonds, the validity of which is questioned, was guarantied, they are equally without the power to enact that the Governor's certification of guaranty shall be the conclusive proof of an indebtedness by the State, and thereby cut off the judiciary from inquiry into the validation of the obligation arising from the guaranty.[3]

[1] Child *v.* New York & New England R. Co. (1880), 129 Mass. 170; s. c. 2 Am. & Eng. R. R. Cas. 329.

[2] State *v.* Clinton (1876), 28 La. Ann. 393.

[3] State *ex rel.*, etc. *v.* Funding Board (1876), 28 La. Ann. 249.

For some of the statutes in some of the States affecting the subject of this chapter see the following: Ark., Dig. 1894, § 6321. Guaranty of bonds of connecting companies; § 6322, By foreign companies connecting. Ind., Rev. St. 1888, § 3951 *a*, 3951 *c*, Guaranty of bonds for construction of a line beneficial to guarantor. See also Rev. St. 1894, §§ 5216, 5218. Kan., Gen. St. 1889, §§ 1247, 1269, 1272, Purchase or guaranty of bonds of another company. Mich., How. Ann. St. 1882, § 3413, Under what circumstances guaranty may be made of bonds of another company. Mont., Civ. Code 1895, §§ 912, 923, Guaranty of bonds of connecting line. Nebr., Comp. St. 1895, § 4026, Guaranty of bonds of connecting line. See New York Stock Corporation Law. Pa., Br. Purd. Dig. 1887, p. 1442, § 738, Guaranty of bonds of another company. S. C., Gen. St. 1882, Guaranty of bonds of connecting road. Tenn., Code 1884, Aid of other roads by purchasing these bonds. W. Va., Acts 1877, ch. 88; Acts 1872–73, ch. 88, § 40. Wash., Code 1891, May own and guaranty bonds of irrigation companies. See article on Power of Companies to Guaranty, 31 Am. L. Rev. 363.

CHAPTER V.

DEFINITIONS OF WORDS AND PHRASES.

§ 94. **Introductory.** — It not infrequently happens that, in seeking to determine the rights of bondholders, the courts find that the inquiry narrows itself down to ascertaining the precise signification of some particular word or phrase occurring in the instrument or statute upon which those rights are founded. In the present chapter it is proposed to give the judicial construction which has been placed upon words or phrases of controlling importance, either by way of explanation or formal definition. But only those cases are cited which embrace other subjects treated of in this book. For convenience of reference, an alphabetical arrangement will be adopted.

§ 95. **All other Property.** — This phrase, when found neither in the beginning of the granting clause of a mortgage, to be afterwards emphasized by a more minute description, nor at the end, as a summary of what precedes it, is interpreted on the principle

of *ejusdem generis*, as being intended to remove any doubt that may arise as to the meaning of the words with which it is immediately connected. Thus where a railway company, in pursuance of a statute, made a mortgage giving the State of Alabama a first lien upon all lands granted by the United States to the company, and "on the telegraph line and telegraph offices along the line of said road belonging to said company; also on the machine shops and 'all other property,'" in four specified States; "also on all coal mines, etc.; also on all iron or mineral lands, etc.," the lien does not extend to certain town lots owned by the company, but not coming within any of the specified classes. In the position in which the disputed words occurred, it was held that they were only designed to cover property of the company in and about the telegraph offices, machine shops, etc., in regard to which a doubt might otherwise arise whether it formed part of those classes of property.[1]

Where a mortgage, after specifying the road and the several parts of it, together with the rolling-stock, added "and 'all other personal property' and rights thereto, and interest therein," the words "all other personal property" were thought *probably* to refer to "property appurtenant to the road, and employed in its operation;" but the case did not require a direct decision of the question.[2]

§ 96. **Apparatus.** — The word "apparatus" in a mortgage by an electric light company includes the lamps.[3]

§ 97. **Appendages.** — The phrase "road and its 'appendages'" in a railroad charter does not include the equipments, cars, engines, or other personal property of the company, but is applied to its real estate.[4]

§ 98. **Appurtenances.** — The meaning of this word, when used in mortgages, is discussed in Chap. IX., *post*.

§ 99. **Charge.** — In the Alabama statute giving a judgment creditor the right to redeem real estate which has been "sold under execution," or by virtue of any decree in chancery, or under any deed of trust or power of sale in a mortgage, . . . or payment bid for the land, interest thereon, and "all lawful 'charges,'" the word "charges" implies every lien, or incumbrance, or claim the purchaser may have upon the premises, and for which, at law or in equity, he would be entitled to hold the lands as security, or

[1] Alabama *v.* Montague (1886), 117 U. S. 602.

[2] Pennock *v.* Coe (1859), 23 How. 117.

[3] Ramsdell *v.* Citizens' Electric Light & Power Co. (1894), 103 Mich. 89; s. c. 61 N. W. 275.

[4] State Treasurer *v.* Somerville & Easton R. Co. (1859), 28 N. J. L. 21.

to the satisfaction of which a court of equity would condemn them. It includes, therefore, a mortgage debt antedating the levy of the attachment in the suit in which the creditor seeking redemption obtained judgment.[1]

A mortgage provided for the approval by the trustees of the expenditure of all moneys realized from the sale of the bonds, and required the written assent of said trustees to all contracts of the company before such contracts should be a "charge" upon said funds. A contractor for the construction of a part of the road claimed a lien upon the funds from the sale of bonds. The court, however, held that the term, as used in the mortgage, did not, in a technical sense, import a lien upon those funds. It simply warranted that a claim such as this of the contractor might be payable out of them. For instance, the company might have appropriated the funds to the satisfaction of such claims, and, by thus depriving itself of their control, have conferred upon the contractor the right to have them applied to reimburse him for services rendered or materials furnished.[2]

§ 100. **Claims.** — In a decree ordering the conveyance of a railroad which had been sold, it was declared that the conveyance should not have "the effect of discharging any part of the said property from the payment of 'claims' or demands chargeable against the same." Several claims were then specifically enumerated, all relating to matters which would come in during the process of the administration. It was held that the word must be confined to these matters, and could not be construed as charging on the purchasers the burden of prior underlying mortgagees, none of which were being foreclosed.[3]

§ 101. **Compromise.** — Under this term are comprehended agreements between two or more persons for the ascertainment of their rights when there is some question in controversy between them, or some difficulty in the enforcement to the uttermost farthing of the rights of the claimant.[4]

§ 102. **Consolidation.** — "The words 'consolidate' and 'consolidation,' as used in statutes authorizing and ratifying the union or combination of several railroad corporations into one, have not acquired a recognized judicial construction which imports that all the companies are dissolved and merged into one new company;

1 Griggs *v.* Banks (1877), 59 Ala. 311.

2 Dillon *v.* Barnard (1874), 21 Wall. 430.

3 Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1887), 30 Fed. Rep. 332.

4 Fry, L. J., in Mercantile Investment Trust Co. *v.* International Co. of Mexico (1893), 1 Ch. 484, n., 68 L. T. 603, n., reprinted in note to 40 Am. & Eng. Corp. Cas., p. 337.

on the contrary, the terms are equally applicable to a union of two or more companies in such a way that one of them is continued in existence, though under a new name and with enlarged powers, while the others are merged in and absorbed by it; and when the statute authorizes the companies to unite and consolidate to such an extent and upon such terms as may be agreed on by and with the company or companies entering into agreement with them, the character of the consolidation is determined by the stipulations of the agreement." [1]

§ 103. **Corpus.** — The *corpus* of an estate is the material object, or species of property, of which the estate is composed. As applied to a railroad, the term embraces the "roadway, embankment, superstructure, and equipment." [2]

The fund obtained from the sale of this property in foreclosure proceedings is, of course, subject to any charges or liens established against the property itself; and although the franchises of the company are not specified by Mr. Justice Bradley in the case just cited as a portion of the *corpus*, this omission is presumably owing to the fact that his definition was given rather in view of the character of the question before him — the right of one occupying another's land in bad faith to be allowed compensation for improvements thereon — than as a comprehensively accurate explanation of the expression. So far as regards liens on the proceeds of the foreclosure sale, there is nothing in the adjudged cases to warrant the conclusion that the money derived from the sale of the franchises is any less a part of the *corpus*, than the money derived from the sale of the rest of the property. It has been held, in fact, that the *corpus* includes franchises and other intangible property, where claims of preferred creditors are in question. [3]

§ 104. **Earnings.** — This word includes the receipts arising from the company's operating as a railroad company, but not those from sales of lands granted to it by the government, nor fictitious receipts from the transportation of its own property. [4] (See also under "Income and Revenues," and "Net Earnings.")

§ 105. **First-mortgage Bonds.** — An agreement by a railroad company to deposit "first-mortgage bonds" as a security for an issue of municipal bonds has been held to have been sufficiently complied with, although the mortgage securing the bonds deposited

[1] Meyer *v.* Johnston (1879), 64 Ala. 603; s. c. 8 Am. & Eng. R. R. Cas. 584.

[2] Jackson *v.* Ludeling (1879), 99 U. S. 513, 521.

[3] Turner *v.* Indianapolis, B. & W. R. Co. (1878), 8 Biss. 315.

[4] Union Pacific R. Co. *v.* United States (1879), 99 U. S. 402.

was junior to one previously given to the State to secure a bond of indemnity for advances made to the mortgagor.[1]

§ 106. **Franchises.** — A "franchise" is a special privilege conferred by government upon individuals, which does not belong of common right to citizens generally. It is not essential to every franchise, even in its legal sense, that it should in all cases be exclusive.[2]

"A corporation is itself a franchise belonging to the members of the corporation; and a corporation, being itself a franchise, may hold other franchises of the corporation."[3]

"The essence of a corporation consists in a capacity (1) to have perpetual succession under a special name and in an artificial form; (2) to take and grant property, contract obligations, sue and be sued by its corporate name as an individual; and (3) to receive and enjoy in common grants of privileges and immunities."[4]

The ordinary franchise of a railroad company is, by virtue of the sovereign power of eminent domain, to condemn, take, and use lands for the purpose of a public highway, and to take tolls from those who use it as such;[5] or, as it has been expressed in another case, the franchise of a railroad is the right derived from the charter to construct and maintain the road in its entire length on the route designated in the charter, and to receive compensation for the transportation of persons or property over that road.[6]

This franchise to maintain and enjoy a road is not restricted and limited to what is barely necessary for that purpose, but extends to what is appropriate and useful and actually in use. It includes the right of appropriating lands for the construction of necessary appurtenances without which the road could not be successfully operated.[7]

[1] Commonwealth *v.* Inhabitants of Williamstown (1892), 156 Mass. 70; s. c. 30 N. E. Rep. 472; 36 Am. & Eng. R. Corp. Cas. 574.

[2] Chicago & Western Indiana R. Co. *v.* Dunbar (1880), 95 Ill. 571; s. c. 1 Am. & Eng. R. R. Cas. 214.

[3] Pierce *v.* Emery (1856), 32 N. H. 484, cited on this point in Coe *v.* Columbus, Piqua, & Indianapolis R. Co. (1859), 10 Ohio St. 372, and in Morgan *v.* Donovan (1877), 58 Ala. 241.

[4] Thomas *v.* Dakin (1839), 22 Wend. 9; see p. 71, Judge Nelson's opinion.

[5] Coe *v.* Columbus, Piqua, & Indianapolis R. Co. (1859), 10 Ohio St. 372, cited in Memphis & Little Rock R. Co. *v.* Railroad Commrs. (1884), 112 U. S. 609; Atkinson *v.* Marietta & Cincinnati R. Co. (1864), 15 Ohio St. 21; Shamokin Valley R. Co. *v.* Livermore (1864), 47 Pa. St. 465, cited in West Pennsylvania R. Co. *v.* Johnston (1868), 59 Pa. St. 290.

[6] Colt *v.* Barnes (1879), 64 Ala. 108.

[7] Northern Pacific R. Co. *v.* Shimmell (1886), 6 Mont. 161; s. c. 9 Pac. Rep. 889; Lawrence *v.* Morgan's L. & Tex. R. & St. Ship Co. (1887), 39 La. Ann. 427; s. c. 2

When the word "franchises" is used in the plural number in a railroad mortgage, it signifies rights and privileges which are essential to the operations of the corporation, and without which its roads and works would be of little value,— such as the franchise to run cars, to take tolls, to appropriate earth and gravel for the bed of its road, or water for the engines, and the like.[1]

It will also include a grant by a municipal corporation of a right of way through certain streets of a municipality, with the right to construct a railroad thereon and occupy them in its use.[2] But exemption from taxation is not ordinarily embraced by this term when used as descriptive of the property which passes to the purchasers at a foreclosure sale. (See Chap. XXXIV.)

§ 107. **Fuel.** — Under a statute giving a lien to "all persons who should do any work or labor in constructing or improving the road-bed of railroad companies within Missouri," and to "all persons who shall furnish ties, 'fuel,' bridges, or materials" to such companies, Mr. Justice Brewer ruled that the word "fuel" did not enlarge the meaning of the other words, "materials, etc.," so as to give it a different meaning from that which "materials" bore in prior statutes, but merely added a specified matter for which a lien was given. The language used could not, therefore, be made to cover an article like lubricating oil, which, although a part of the supplies necessary for the operation of the road, did not go into the permanent structure and thus come within the principle underlying the statutes which give a lien for labor and materials.[3]

In another case it was contended that a lien should be awarded for certain scales, trucks, letter-presses, and similar articles, on the ground that, by the use of the word "fuel" the legislature intended to enlarge the scope of the word "materials," and make it include everything which passed, not merely with the structure, but into the permanent equipment; but the same learned judge adhered to the opinion he had expressed in his first opinion, and refused to allow the claim.[4]

So. Rep. 69; 30 Am. & Eng. R. R. Cas. 309; see also 20 Am. L. Rev. 867 *et seq.*; Pierce *v.* Emery (1856), 32 N. H. 484; Hatcher *v.* Toledo, Wab. & West. R. Co. (1872), 62 Ill. 477; s. c. 16 Am. Ry. Rep. 405.

[1] Morgan *v.* Louisiana (1876), 93 U. S. 217.

[2] New Orleans, Spanish Fort, & Lake R. Co. *v.* Delamore (1885), 114 U. S. 50; s. c. 5 Sup. Ct. Rep. 1009.

[3] Central Trust Co. *v.* Texas & St. Louis R. Co. (Waters Pierce Oil Co., Intervener) (1885), 23 Fed. Rep. 703.

[4] Central Trust Co. *v.* Texas & St. Louis R. Co. (Borden, Intervener) (1886), 27 Fed. Rep. 178.

§ 108. **Going Concern.** — This expression is properly applied to a corporation which, although it may be insolvent, still continues to transact its ordinary business.[1]

This term cannot be used of a railroad unless it is constantly in operation. If the rolling-stock is lying idle in the round-houses or upon the tracks, the company is not discharging the duty it owes to the public for the franchises granted to it. To discharge this obligation, the company must keep its road in operation, transporting passengers and freight.[2]

§ 109. **Income and Profits.** [In hands of receiver for creditors.] — The phrase "income and profits" signifies the surplus after all expenses and repairs and necessary replacements have been made.[3]

§ 110. **Income and Revenues.** — In the "income and revenues" of a railroad company are included all the income and revenues of the company, and these words necessarily embrace the "earnings" of the road, when used in a statute creating a lien in favor of the State, as a security for a loan of its bonds.[4]

§ 111. **In such Case.** — Where a clause in a mortgage provided that, in case the payment of interest should be in default for six months the whole principal of the bonds should, at the option of the holders of a majority in interest of the bonds, become due and payable; and it was declared further that, "in such case," it should be lawful for the trustee to enter on and operate the road, it was held that a mere default in the payment of interest for six months was not enough to confer this extraordinary power

[1] White, Potter, & Page Mfg. Co. *v.* Pettee's Importing Co. (1887), 30 Fed. Rep. 865.

In Green *v.* Coast Line R. Co. (1895), 97 Ga. 15, 37; s. c. 24 S. E. Rep. 814, 820, the late Chief Justice Buckley refers to the doctrine of a debt against a company assuming a preferential character, as against the claims of bondholders by reason of its having been incurred in keeping the road a "going concern," in these words: "There seems to be a theory that if mortgaged roads can be kept 'going concerns,' it matters not what else may stop. That the public is decidedly the most important 'going concern' in existence appears to be overlooked. As a part of the public the husband and son of Mrs. Green were 'going concerns,' and the going of the railroad was the cause of their ceasing to be such. The cases on which we are animadverting would treat as a preferential debt a claim for the coal or wood consumed in generating the steam which killed them, but would deny any preference whatever to a judgment for damages resulting from the homicide. Public policy certainly favors keeping the franchises active, but it favors more the security of all who as a part of the public are liable to suffer by their activity. No policy is subserved by going wrong. Nonfeasance is better than misfeasance; idleness is better than homicidal mischief resulting from a vicious or negligent activity."

[2] Eells *v.* Johann (1886), 27 Fed. Rep. 327.

[3] Strang *v.* Montgomery & Eufaula R. Co. (1879), 3 Woods, 613, 619.

[4] Tompkins *v.* Little Rock & Fort Smith R. Co. (1884), 15 Fed. Rep. 6, 14.

on the trustee, and that the words "in such case" implied that the right of entry was to arise only after the option of the bond-holders had been exercised in the manner specified.[1]

§ 112. **Labor and Supply Creditors.** — These words include such as have wrought and given of their substance under promises of prompt payment from the railway company, and for that reason are preferred creditors of the income.[2]

§ 113. **Laborer.** — The term "laborer," in an order requiring the mortgagees to pay claims for services, embraces counsel engaged by the receiver for services necessary to the successful management of the road.[3]

Railroads are made liable by Rev. Stats. Me., c. 52, § 141, for the wages of laborers employed by contractors for labor actually performed on the road. One who superintends the building of bridges at an agreed compensation of seven dollars per day, keeps an account of the men's time and makes out their pay-rolls, has been held not to be a "laborer" within the meaning of this statute.[4]

§ 114. **Lien.** — Taken in its widest sense, the term "lien" includes every case in which personal or real property is charged with the payment of a debt. Statutory liens depend upon the construction of the statute, and contract liens on the terms of the contract."[5]

A common-law lien has been defined as a right in one man to retain that which is in his possession belonging to another, till certain demands of him, the person in possession, are satisfied;[6] but this definition is clearly too narrow to cover equitable liens,

[1] Union Trust Co. *v.* Missouri, K. & T. R. Co. (1880), 26 Fed. Rep. 485.

[2] Frank *v.* Denver & Rio Grande R. Co. (1885), 23 Fed. Rep. 123, 128.

[3] Bayliss *v.* Lafayette, Muncie, & Bloomington R. Co. (1879), 9 Biss. 90.

[4] Blanchard *v.* Portland & Rumford Falls Ry. (1895), 87 Me. 241; s. c. 32 Atl. Rep. 890.

It was said in the opinion: "In the construction of statutes similar to our own, it has been held that the word 'laborer' does not include a book-keeper or a superintendent:" Wakefield *v.* Fargo (1882), 90 N. Y. 213; nor a civil engineer: Pennsylvania & Delaware R. Co. *v.* Leuffer (1877), 84 Pa. St. 168; s. c. 24 Am. Rep. 189; nor an assistant engineer: Brockway *v.* Innes (1878), 39 Mich. 47; s. c. 33 Am. Rep. 348; nor one who has contracted to do a certain amount of grubbing, notwithstanding he labors with the men employed by him to do the work: Rogers *v.* Dexter & Piscataquis R. Co. (1893), 85 Me. 372; s. c. 27 Atl. Rep. 257.

[5] Sullivan *v.* Portland & Kennebec R. Co. (1874), 4 Cliff. 212, 225. For general discussion of the meaning of this word see 19 Am. Law Rev. 783. See also Peck *v.* Jenness (1849), 7 How. 612, 619.

[6] Hammons *v.* Barclay, 2 East, 227. That the use of the word "lien" in a statute may not always be conclusive as to the actual existence of a lien, see Tompkins *v.* Little Rock & Fort Smith R. Co. (1888), 125 U. S. 109; s. c. 8 Sup. Ct. Rep. 762.

and the liens created by statute for the benefit of certain classes of creditors with specially meritorious claims.

§ 115. **Materials.** — In Central Trust Co. *v.* Texas & St. Louis R. Co.[1] it was said that, when employed in relation to railroads, the word "materials," in statutes giving laborers, etc., a lien, is limited to such articles as pass into the permanent structures and equipment of the company. (See *supra*, as to fuel not being "material" in this sense.)

In a railroad mortgage the word "materials" relates only to such materials as the railroad company there had, and which were capable of being conveyed. If the words "used in operating the road" relate to all kinds of property specifically named, the word "materials" would be limited by them. The word does not cover "chairs" which were lying on the ground in stacks and had never become appurtenant to the road.[2]

Coal furnished to an electric light and power company, used by it to operate its plant, has been held to be "material furnished" within the meaning of section 1255, Code of North Carolina, which disables corporations from mortgaging their property freed from liability on judgments obtained against them "for labor performed, for material furnished," etc.[3]

§ 116. **Maturity.** — The word "maturity," in its application to bonds and similar instruments, refers to the time fixed for their payment, which is the termination of the period they have to run.[4]

§ 117. **Moneys.** — Where the mortgage conveys "all the income, rents, tolls, profits, receipts, 'moneys,' rights," etc., the use of the word "moneys" does not enlarge the rights of the mortgagee so as to convey to him such moneys as are simply past income or earnings. The words are prospective, not retrospective, in their operation; the only exception to this rule being the case in which the mortgagor has in his possession moneys received from the sale of rolling-stock, lands, or other tangible property.[5]

§ 118. **Net earnings** have been variously defined as the excess of the gross earnings over the expenditures defrayed in producing them aside from and exclusive of the expenditures for construction and the ordinary expenses incident to operating and

[1] 23 Fed. Rep. 703 (1885).

[2] Farmers' Loan & Trust Co. *v.* Commercial Bank (1860), 11 Wis. 211.

[3] Pocahontas Coal Co. *v.* Henderson Electric Light & Power Co. (N. C., 1896), 24 S. E. Rep. 22.

[4] United States *v.* Union Pac. R. Co. (1875), 91 U. S. 72.

[5] Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 772.

maintaining the roads and works of a railroad company;[1] as the gross receipts, less the expenses of operating the road to earn such receipts,[2] or what is left of the income after paying the legitimate cost and expense of working earnings by the use of the property.[3]

Nor "is the meaning of 'net earnings' limited to earnings in any one particular mode, but the expression is broad enough to include the revenue to be derived from the property in any manner."[4]

Thus, where a company operates leased roads in addition to its own, the "'net earnings' of the road" are not limited to those derived from its own road, but embrace all those which accrue from the business done on the leased roads also.[5]

But the net earnings of one of the roads may also be segregated by the express terms of the mortgage; as where the L. railroad gave the C. railroad a mortgage of the "net earnings" of all business coming to it from the C. road. In this case the "net earnings" specified were ascertained by deducting from the gross receipts of such business the expenses of operating the road by which the receipts were earned. The expenses were found by proportion, and the proper proportion charged to the business in dispute.[6]

For further information as to this term, see 25 Am. L. Reg. N. S. 558, and the notes in 1 Am. & Eng. R. R. Cas. 517, and 23 Am. & Eng. R. R. Cas. 745.

[1] Union Pacific R. Co. *v.* United States (1879), 99 U. S. 402, 420; followed in Barry *v.* Missouri. K. & T. R. Co. (1886), 27 Fed. Rep. 3, 5.

In United States *v.* Kansas Pacific Ry. Co. (1879), 99 U. S. 455, the court excluded the money needed to place the road in proper repair, but not actually expended for that purpose, the expenses of the Land Department and the interest on the funded debt, which had priority over the lien of the United States, from the amount to be charged against the gross earnings to ascertain the "net earnings;" but allowed the equipment account, or replacing and rebuilding rolling-stock, machinery, etc., the amounts paid for depot grounds and the expenses of the same, and the construction account, or improvements and additions to the track, where they had been actually paid out of the earnings of the road, to be deducted.

[2] St. John *v.* Erie R. Co. (1872), 10 Blatch. 271, affirmed in St. John *v.* Erie R. Co. (1874), 22 Wall. 136, 149.

[3] Vermont & Canada R. Co. *v.* Vermont Central R. Co. (1877), 50 Vt. 500; s. c. 14 Am. Ry. Rep. 497.

[4] Phillip's Trustee *v.* Eastern R. Co. *et al.* (1884), 138 Mass. 122, 128; s. c. 22 Am. & Eng. R. R. Cas. 247, in which case the words of the statute were referred to by the court in these words: "The phrase 'net earnings,' as used in this act, is substantially synonymous with 'net income' or 'net profits,' and required all the sums received for a lease of the road to be applied as the statute required the net earnings to be applied."

[5] St. John *v.* Erie R. Co. (1874), 22 Wall. 136.

[6] Schmidt *v.* Louisville & N. R. Co. (1894), 95 Ky. 289; s. c. 25 S. W. Rep. 494.

As to the meaning of "earnings," "income," and "revenues," see those words.

"Net earnings," in a by-law providing that dividends should be paid therefrom, are the gross receipts, less the expenses of operating the road, and less also interest on such of the company's indebtedness as it is prudent and proper to keep in a permanent form, and less also any floating or temporary liabilities which good judgment would require to be presently paid, and less also any annual contribution to a sinking fund for the payment of debts, whenever expedient and proper to provide such a fund.[1]

§ 119. **Operating Expenses.** — Interest on receivers' certificates made payable out of the *corpus* of the mortgaged property, and costs and allowances to the master or other officers of court, are not a part of the "operating expenses" of a road to be taken into account in determining the "net earnings" of a road.[2]

A Massachusetts statute, passed for the relief of a railroad company, provided that it might mortgage its property, and that, after default in the payment of interest should continue for twelve months, the trustees named might, at the request of a certain proportion of the bondholders, take possession and proceed to foreclosure; but no provision was made for disposing of the gross income of the corporation while it was in control of the road, except that authority was given for applying the net earnings over and above operating expenses to certain specified purposes. It was held that, until the mortgagees should enter, the income of the road remained liable to attachment by trustee process founded on claims arising out of the operation of the road since the statute went into effect, and that a claim founded on damage done to property at a crossing must be paid to one suing by such process, as a part of the "operating expenses," which the company was empowered to liquidate before the application of the earnings, in pursuance of the act.[3]

In a later case an attempt was made to show that the interest on certain bonds securing a loan and guarantied by the lender came under the "operating expenses" mentioned in the same statute; but this view did not prevail.[4]

Where a railroad company is authorized by a statute embodying a compromise agreement to remain in possession, and apply

[1] Belfast & Moosehead Lake R. Co. *v.* City of Belfast (1885), 77 Me. 445; s. c. 1 Atl. Rep. 362; 23 Am. & Eng. R. R. Cas. 736.

[2] Blair *v.* St. Louis, K. & T. R. Co. (1885), 25 Fed. Rep. 232, 234.

[3] Smith *v.* Eastern R. Co. (1878), 124 Mass. 154.

[4] Eastern R. Co. *v.* Rogers (1878), 124 Mass. 527.

to the payment of the incumbrances any portion of its net earnings over and above its "operating expenses," including therein its necessary expenditures for construction, insurance, taxes, renewals, and repairs needful to maintain its road in good condition, and its rentals, certificates of indebtedness, and such payments as may be required by the statute, the term "operating expenses" has a wider scope than that which it ordinarily bears.[1]

The "operating expenses" which are commonly to be paid under reorganization schemes before the common stockholders are entitled to the benefit thereof do not include money spent on steel-rail betterments, or on steamers owned by the company to make them more efficient, or the purchase of engines and cars. Nor should the expense account be charged with an estimate depreciation, where the money so charged was not actually spent upon repairs.[2]

§ 120. **Past due Interest.** — This term can only mean interest which has matured and which is collectible on demand.[3]

§ 121. **Preferred Stock.** — Stock of this description differs from other capital stock merely in the preference given to it in the payment of dividends, and does not confer on the holder any other privilege or entitle him to priority in any other respect.[4]

A preferred "stockholder" is, therefore, not a creditor; nor is a dividend guaranteed to him.[5]

§ 122. **Profits used in Construction.** — This expression does not embrace earnings expended in repairs for keeping the property up to its normal condition, but refers to new constructions adding to the permanent value of the capital; and when these are made

[1] Phillips *v.* Eastern R. Co. (1886), 138 Mass. 122; s. c. 22 Am. & Eng. R. R. Cas. 247.

[2] Mackintosh *v.* Flint, P. & M. R. Co. (1888), 34 Fed. Rep. 582; s. c. 36 Am. & Eng. R. R. Cas. 340.

[3] Coquard *v.* Bank of Kansas City (1882), 12 Mo. App. 261.

[4] St. John *v.* Erie R. Co. (1872), 10 Blatch. 271; State *ex rel.*, etc. *v.* Cheraw & Chester R. Co. (1881), 16 S. C. 524.

In the latter case the court said: "The word 'preferred' is relative to something else, and it means that the thing to which it is attached, whatever that may be, has some advantage over other things of the same character, which but for this advantage would be like the former. If then the term 'stock,' when employed in connection with railroad or other chartered companies, means money invested in the business of the company, represented by certificates of shares known as 'capital' or 'capital stock,' and there is no other known stock belonging to such companies having a distinct and separate characteristic from 'capital stock,' what effect can the word 'preferred,' when attached to it, have except to indicate that in the case it is to have some advantage which otherwise it would not have? In other words, in such case can it be anything else than '*preferred* capital stock,' or a '*preferred* interest' in the money paid in by stockholders, divided into shares and represented by certificates showing the share of each holder?"

[5] Belfast *v.* Moosehead Lake R. Co. *v.* City of Belfast (1885), 77 Me. 445; s. c. 23 Am. & Eng. R. R. Cas. 736.

to take the place of prior structures, it includes only the increased value of the new over the old when in good repair.[1]

§ 123. **Property.** — A mortgage conveying "all the present and in future to be acquired 'property' of the L. Branch of the B. & S. W. R. Co., *that is to say*, all the branch railroad," etc. (these words being followed by a detailed description of the different kinds of property embraced by the general words), do not cover the interest which the mortgagor has previously acquired in municipal subscriptions which have been previously obtained and accepted by the company for the purpose of raising money to build the road. The court conceded that the word "property" was sufficiently broad and comprehensive to include every kind of possession and right, and that "in its literal acceptation it might include such rights, whether legal or equitable, absolute or contingent, as the railroad company had acquired" under the aid-bonds; but was of opinion that such a construction of the mortgage was not imperatively demanded, and was also inconsistent with the intention of the parties, as deduced, according to the ordinary rules established for the interpretation of written instruments, from the addition of the explanatory phrase, "that is to say," and the subsequent enumeration of several specific kinds of property.[2] See also § 95.

§ 124. **Protected.** — In Wabash, St. L. & Pac. R. Co. *v.* Ham[3] it was contended by the holders of certain unsecured equipment bonds, issued by one of the companies which had entered into a consolidation agreement, that a stipulation in that agreement that the bonds and debts of the former companies "shall be protected by the said consolidated company" created a lien in their favor. The court, however, declined to accept this view. As the agreement "to protect" expressly referred to the time of payment, and the effect of the "equipment bonds" had been merely to create a personal and unsecured debt of one of the former companies, the words "shall be protected" must be taken to have the same meaning which they ordinarily have in promises of men of business to "protect" drafts or other debts not made or contracted by themselves, — that is to say, a personal obligation to see that they were paid at maturity.

§ 124 *a*. **Railway.** — A Canadian court has said: "There is no technical meaning in the term "railway." A tramway and street railway are both railways in the sense of a road constructed with

[1] Grant *v.* Hartford & New Haven R. Co. (1876), 93 U. S. 225.

[2] Smith *v.* McCullough (1881), 104 U. S. 25.

[3] 114 U. S. 587 (1885).

parallel lines of rails on which cars or trains operate. They may both be moved by the same power, but there the analogy ends." [1]

§ 124 *b*. **Road-bed.** — This word, when used in reference to railways, means the foundation on which the superstructure of the railway rests, and the superstructure is the sleepers or ties, rails and fastenings. This includes the side tracks, which form a part of the railway.[2]

§ 125. **Road and Property.** — A statute by which certain bonds issued by the State of Missouri were to be a first lien on a "road and its appurtenances" was amended so as to make the same bonds a lien on the "road and property" of the company. It was held that this alteration must be presumed to have been made advisedly, and to have been intended to enlarge the application of the lien. The word "property" was therefore taken to comprehend the lands which had previously been granted by Congress to aid the construction of the road, and by the State to the railroad company, and the contention negatived, that the lien of the State was confined to the road and such property immediately connected with the road as was necessary for its operation.[3]

§ 125 *a*. **Servant and Employee.** — Words "servant" and "employee" in act providing that a court granting a foreclosure decree should order that the purchaser should pay "all sums due by the foreclosed company to a servant or employee," do not include a secretary of the company.[4]

This decision was to a great extent rendered out of deference to the supposed effect of a previous decision in the State court.[5]

[1] Edison Gen. Electric Co. *v.* Edmonds (1895), 4 Br. Col. Rep. 354, holding the Railway Act of Canada not to apply to undertakings in the nature of tramways or street railways.

[2] Standard Insurance Co. *v.* Langston (1895), 60 Ark. 381, 385, citing Santa Clara County *v.* Southern Pac. Ry. (1886), 118 U. S. 394, 413; San Francisco *v.* Central Pacific R. Co. (1883), 63 Cal. 467, 469; San Francisco, etc. R. Co. *v.* State Board (1882), 60 Cal. 12, 34; Cass County *v.* Chicago, B. & Q. R. Co. (1889), 25 Neb. 348, 353.

[3] Wilson *v.* Boyce (1873), 2 Dill. 539, affirmed in Wilson *v.* Boyce (1876), 92 U. S. 320.

This case was commented on and distinguished in Alabama *v.* Montague, 117 U. S. 602, where the words "all other property" occurring in the middle of an enumeration of several kinds of property, were construed on the principle of *ejusdem generis*, and held not to extend to lands which did not fall within the classes of property specified. See § 95, *ante*.

[4] Wells *v.* Southern Minn. Ry. Co., 1 McCrary, 18.

[5] Whitehead *v.* Vineyard (1872), 50 Mo. 30. There, after a consideration of all the acts relating to the lands, of the policy of the State in regard thereto, and of the contemporaneous construction which various officials appeared to have placed upon the legislation, it was determined that the lands were not covered by the phrase in question.

But the opinion of the Missouri court, as given in a recent case, is to the effect that Whitehead *v.* Vineyard was not intended to have the scope attributed to it by the federal courts, and, so far as the ruling of the latter is a matter of mere precedent, its authority is seriously shaken.[1]

§ 126. **Sinking Fund.** — This term signifies a fund created for extinguishing or paying a funded debt.[2]

§ 127. **Stock. Capital Stock.** — The words "stock" and "capital stock" may be defined as meaning the fund or property belonging to a firm or corporation, and used to carry on its business.[3]

When shares of "stock" of a corporation or a majority of shares are spoken of in statutes, it usually refers to the subscribed or issued or outstanding shares.[4]

§ 128. **Tax.** — The State of Arkansas passed an act which provided for the issue of aid-bonds, and declared, among other things, that a "tax" should be imposed from time to time on any railroad company, to which the bonds should be issued, such "tax" to be equal in amount to the annual interest upon the bonds then outstanding and unpaid, and further that the "taxation" was to continue until the amount of bonds issued to such company with the interest thereon should have been paid by the company, in which case the said road should be "entitled to a discharge from all claims or *liens* on the part of the State." It was held in the Supreme Court of the United States that the exaction made by the State, under such circumstances and for such purposes, was not a "tax," although so designated, and that the statute, therefore, did not create any charge on the property of the company which could be enforced by the purchasers of the bonds, their only remedy being against the State. It was denied that the provision for the "discharging from all claims or liens" was sufficient of itself to establish a lien, if the lien did not otherwise attach. Such a provision, it was conceded, might be used in aid of construction, if there were any doubt; but, upon an examination of the rest of the statute, the conclusion reached was that

[1] Wilson *v.* Beckwith (1893), 117 Mo. 61; s. c. 22 S. W. Rep. 639. In this case it was held that the lien created by the act of 1857, March 3, did not extend the State's lien over the railroad's lands granted by Congress to the State and by the State to the company.

[2] Ketchum *v.* City of Buffalo (1856), 14 N. Y. 356, 379; Chicago & I. R. Co. *v.* Pyne (1887), 30 Fed. Rep. 86.

[3] Commonwealth *v.* Lehigh Avenue Ry. Co. (1889), 129 Pa. St. 405, 414; s. c. 18 Atl. Rep. 414, 498; 7 Ry. & Corp. L. J. 43.

[4] Market Street Ry. Co. *v.* Hellman (1895), 109 Cal. 571, 588; s. c. 42 Pac. Rep. 221.

there was nothing therein from which the creation of a lien might be reasonably implied.[1]

§ 129. **Terms, Conditions, and Limitations.** — A mortgage contained a provision to the effect that, in case of a foreclosure sale, and a written request by a majority of the bondholders, the trustee might purchase the property for the use and benefit of those bondholders, after which he might take such lawful measures as he deemed for the interest of the said bondholders, to organize a new company for their benefit, the organization to be effected upon such "terms, conditions, and limitations," and in such a manner as the holders of a majority of the outstanding bonds secured by the mortgage should direct. It was held that the primary object of the deed being to secure to the bondholders a prior right to the entire property, the subject of the trust, so far as it was needed for the payment of the bonds, no exception could be taken to a decree which fully preserved this right, and directed an organization of the new company which was for the benefit of the bondholders. "The power" (to carry out the reorganization), said Mr. Justice Strong, "was coupled with a large discretion. The majority was authorized to define the 'terms, conditions, and limitations' under which the new company should be organized. What those should be was thus left to the discretion of the donors of the power. 'Terms, conditions, and limitations' are broad words. Let it be conceded that the new organization must be for the benefit of the holders of the first-mortgage bonds, how can we say it is not for the benefit of those holders that entirely subordinate interests are conceded to junior lien creditors and to the stockholders of the former corporation? How can we say that such a concession was beyond the discretion with which the agents of the bondholders, that is to say, the majority, were clothed? Such concessions are generally made in reorganization of railroad companies, and they are regarded as beneficial to the joint lienholder.[2]

§ 129 *a*. **Written Assent.** — The "written assent" required by the statute of New York of stockholders to the execution of a mortgage by a corporation is accomplished by the adoption of a resolution authorizing the issue of such a mortgage at a meeting of stockholders by a vote of those holding more than two-thirds of the stock, and entered on the minutes and attested by the secretary.[3]

[1] Tompkins *v.* Little Rock & Fort Smith R. Co. (1887), 125 U. S. 109; s. c. 8 Sup. Ct. Rep. 762, affirming s. c. 18 Fed. Rep. 344.

[2] Sage *v.* Central R. Co. (1878), 99 U. S. 334, 343.

[3] Beebe *v.* Richmond Light, Heat, & Power Co. (1895), 13 Misc. Rep. (N. Y.) 737; s. c. 35 N. Y. Suppl. 1.

CHAPTER VI.

CONSTRUCTION CONTRACTS.

It is not of course within the scope of this work to cite all cases involving contracts for the construction of railroads. Such contracts generally provide for the payment of the work done, in the securities of the company, and only questions arising out of this feature of such contracts, with a few exceptions, are considered here. Construction contracts should be entered into with due reference to any provisions of the constitution and statutes of the State under whose law the company is created, or which govern the issue of securities provided for in the contract.

§ 130. **Construction Contracts violating Constitutional or Statutory Provisions.** — Reference to constitutional provisions touching this subject are given in a note to Chapter I.[1]

Some constitutions, as will be seen by reference to Chapter I., provide that "no corporation shall issue stock or bonds, except for money, labor done, or property actually received, and all fictitious increase of stock or indebtedness shall be void." It has been held that the object of such a provision in the Pennsylvania Constitution was to interdict every issue of stock or bonds which does not, in good faith, represent a consideration in labor done, or property or money received, substantially corresponding in value with the face amount of the issue. An issue of stock and bonds to a contractor, with a face value of more than three times the value of the labor and materials furnished by him, was accordingly set aside at the suit of the corporation.[2]

Nor can a construction contract stand which involves an issue

[1] See *supra*, Chap. I.
[2] New Castle Northern R. Co. *v.* Simpson (1884), 21 Fed. Rep. 533.

of bonds entirely disregarding a statute which enacts that railroad companies shall be limited in their indebtedness to the amount of the capital stock subscribed, and authorizes an issue of bonds not to exceed double the amount actually paid up of the stock subscribed, with a further provision that the indebtedness cannot be increased beyond the amount of stock subscribed until the subscriptions shall have been fully paid in.[1]

§ 131. **Securities issued under Construction Contracts held invalid because Directors were interested.** — The rights of the holders of bonds issued in pursuance of a construction contract are sometimes determined by an application of the well-settled principle that a transaction in which the directors have a personal interest opposed to the interest of their company will be set aside at the instance of parties interested. Thus in a case in which two directors were to derive benefit from a construction contract, and the construction company furthermore agreed to relieve twelve shareholders in the railroad company from paying any subsequent assessments on the stock they had subscribed for, it was held that the contract could not be enforced in equity, when resisted by other shareholders, and that the mortgage bonds issued in pursuance of the contract to the construction company were voidable at the election of those affected by the fraud, until they passed into the hands of *bona fide* purchasers.[2]

So, also, where bonds were issued to a contractor, and by him assigned to a director who was concerned in awarding the contract, the court ordered them to be delivered up, on the ground that, if they should pass into the hands of an innocent holder, the company would be liable upon them.[3]

§ 132. **Lien of Construction Contracts.** — This matter is important as affecting the relative rights of the contractor and the bondholders, but construction contracts are not generally intended to give any lien to the contractors, nor is it the tendency of the courts to endeavor to establish such liens.

[1] But it is to be observed that the opinion in this case does not show whether the stocks and bonds received by the contractor were issued as a payment for labor and materials.

[2] Thomas *v.* Brownville, Fort Kearney, & Pac. R. Co. (1883), 109 U. S. 522. See also Barr *v.* New York, L. E. & West. R. Co. (1891), 125 N. Y. 263; s. c. 9 Ry. Corp. & L. J. 174; 26 N. E. Rep. 145.

[3] Flint & Marquette River R. Co. *v.* Dewey (1866), 14 Mich. 477. The general principle referred to in the text is enforced in the following cases, among others: Twin Lick Oil Co. *v.* Marbury (1875), 91 U. S. 587; Wardell *v.* Union Pac. R. Co. (1880), 103 U. S. 651, affirming s. c. 4 Dill. 330, 339; Gardner *v.* Butler (1879), 30 N. J. Eq. 702; European & N. A. R. Co. *v.* Poor (1871), 59 Me. 277; Great Luxembourgh R. Co. *v.* Magenay, 25 Beav. 586; Benson *v.* Heathon, 1 Y. & Coll. 326.

(a) *Contract when not a Lien on the Proceeds of Bonds.* — There are no reported cases, it is believed, where the construction contract has been held to give the contractor a lien upon the proceeds of the bonds. In the absence of a statutory provision, the general rule is that unsecured floating debts for construction are postponed to the lien of a valid mortgage duly recorded, and of bonds secured thereby and held by *bona fide* purchasers for value.[1]

If, therefore, there is no statutory provision, the question whether, in any given case, the contractor has obtained a lien upon the whole or a specific part of the company's property, superior to that of a subsequent mortgage, must be determined by general equitable principles, the rights of the parties being ascertained by a consideration of the mortgage and the construction contract.[2]

[1] Porter *v.* Pittsburg Bessemer Steel Co. (1887), 120 U. S. 649; s. c. 30 Am. & Eng. R. R. Cas. 472. In this case the court remarked that it was not aware of any well-considered adjudged case that sustained the contrary proposition.

[2] In Dillon *v.* Barnard (1874), 21 Wall. 430, affirming s. c. 1 Holmes, 386, a provision made the assent of the trustees necessary "before the expenditure should be a *charge* upon any of the sums received." It was argued that the word *charge* was here synonymous with *lien*, and that a specific lien was created in the contractor's favor when the trustees had consented to the payment of his claim; but the court rejected this construction, being of the opinion that the context showed the word to have been employed in the general acceptation of a claim that might be made payable out of the proceeds, and not in any technical sense. The clause was designed not for the benefit of the contractor, but to increase the security against a wasteful expenditure of the proceeds. Mr. Justice Field remarked that the case was not different, in its essential features, from those cases of daily occurrence where the expectation of a contractor that funds of his employer derived from specific sources will be devoted to the payment of his services or materials, is disappointed, and laid down the general rule as follows: "Before there can arise any lien on the funds of the employer, there must be, in addition to an express promise, upon which the contractor relies, some act of appropriation on the part of the employee depriving himself of the control of the funds, and conferring upon the contractor the right to have them applied to his payment when the services are rendered or the materials are furnished. There must be a relinquishment by the employer of the right of dominion over the funds, so that without his aid or consent the contractor can enforce their application to his payment when his contract is complete." The clause merely meant that, as against the parties to the mortgage, the contractor was not entitled to any benefit except that, upon the assent of the trustees being given to his contract, the use of the moneys for their payment was permissible. This being the proper construction of the provision, it amounted practically to nothing more than a condition precedent to the use of the proceeds of the bonds to pay the contractors. The reporter cites in a note several cases in support of this general proposition. See also Wright *v.* Ellison (1863), 1 Wall. 16. For a case in which it was ruled that the priority of a lien could not be established by mere implication from an agreement by which the owner of a railroad guaranties to the holders of unsecured contract claims that in consideration of their clearing off all claims against the company which may be declared by the court to be liens upon the railroad, paramount to the lien of a subsequent mortgage and the

(b) *Contract when not a Lien on the Constructed Road.* — In Wright *v.* Kentucky & Great Eastern Ry. Co.[1] the court refused, under the particular circumstances of the case, to declare a lien in favor of a construction company, the terms of the contract being inconsistent with the idea of any ownership of the completed road by the contractors or the possession by them of any lien thereon.

(c) *Statutory Lien of Construction Contracts.* — The extent to which a contractor or other material-man obtains by his services a lien on the property of the company is a matter which, in most instances, is to be decided with reference to the statutes enlarging the common-law rights of this class of creditors. One of the earliest of these enactments, the Pennsylvania resolution of Jan. 21, 1843, declared that it should not be lawful for a company engaged on the construction of a railroad or other work of

bonds secured thereby, "the claims, liens, and possible indebtedness" to be thus disposed of shall not exceed a certain sum, see Porter *v.* Bessemer Steel Co., 120 U. S. 649. Such a clause merely provides for the rights of the parties as between themselves, in case the court establishes the priority referred to.

[1] 117 U. S. 72 (1888). In this case the construction company under its contract was to have all the money, municipal bonds, and property issued or given in payment of subscriptions to stock, and all stock not necessary to maintain the charter, or not issued to municipal corporations for subscriptions to stock, and also two issues of bonds, one secured by a mortgage as "a first lien" and the other secured by an equipment mortgage. This, it was said, was tantamount to giving the company everything except the road, and the railroad company was necessarily to have and own that, so as to be able to give a mortgage on it as a "first lien." It was further held that a provision in the contract giving to that company all the earnings of the road "during construction" and "until accepted" by the railroad company, was vague and indefinite, and could not be construed as giving a lien, for that would be inconsistent with the whole tenor of the instrument.

In the same case it appeared that the construction company had done some work on the road purchased by the railroad company, and for this work the assignees in bankruptcy of the former claimed a lien. It was held that, as the contractors when they made the contract were aware that the title by which the road was held was conditional and liable to be divested, upon a breach of the condition, by the re-entry of the grantor, they could not claim a lien after the grantor had exercised the rights reserved and resumed.

Fifty miles of a railway in Manitoba was built and equipped under an agreement with a contractor, which entitled him to a lien on the same, and a right to hold possession of the railway and the franchise, rolling-stock, land grant, etc., which belonged to it, as security for the sum due him for its construction. He obtained judgment for the amount due for the construction, and the company was given six months by order of the court to pay it, with interest. Having defaulted, the contractor obtained a second judgment, which ordered the possession of the railway, etc., to be delivered to him, and perpetually restraining the company from sale, negotiation, or issue of bonds, and from dealing with the land grant. The Court of Queen's Bench for Manitoba overruled a demurrer to this bill of the contractor to compel the delivery of possession, etc., as ordered in the court rendering judgment in his favor, holding such an agreement to be within the power of the company. Charlebois *v.* Great North West Central Ry. Co. (1892), 9 Man. 1.

internal improvement to execute a mortgage or other transfer of its property so as to defeat the claims of contractors, laborers, and workmen, which were at the time unpaid. It was held in Fox *v.* Seal[1] that the lien thus given was of indefinite duration; that, in whatever shape the contractor's debt might be, it retained the benefit of the privilege conferred on it by the resolution; and that the lien was consequently not merged in any judgment obtained by the contractor against the company for his debt, nor lost owing to the fact that the lien of such a judgment was allowed to expire by lapse of time. And if the contract itself is set aside as being *ultra vires*, and the court allows the contractor compensation for the work actually performed by him, he is entitled, under the same resolution, to a lien for the sum allowed.[2]

The resolution of Jan. 21, 1843, is a protection to the contractor only where his claims accrued prior to the execution of the mortgage.[3]

§ 133. **The Equities of the Contractor.** — The rule is well settled that, where a company procures the rescission of a construction contract, on the ground that it is fraudulent, *ultra vires*, against public policy, or in violation of constitutional or statutory provisions, the court will require the complainants, agreeably to the principle that he who seeks equity must do equity, to compensate the contractor for what he has done. He is not, in such a case, to be put off with a bare reimbursement for his actual outlay, but is entitled to have the value of his work estimated as on a *quantum meruit*, without regard to the prices fixed by the contract.[4]

[1] 22 Wall. 424 (1874).

[2] New Castle R. Co. *v.* Simpson (1886), 26 Fed. Rep. 133.

[3] Reed's Appeal (1888), 122 Pa. St. 565; s. c. 16 Atl. Rep. 100. As to statutory liens for construction and their priority over mortgage bonds, see McIlhenny *v.* Binz (1890), 80 Tex. 1; s. c. 13 S. W. Rep. 655. So far as mechanics' and laborers' liens have actually come into conflict with liens of mortgages, they are treated in the chapter on priorities. See Chap. XI., *post.*

[4] Porter *v.* Bessemer Steel Co. (1889), 120 U. S. 649; Thomas *v.* Brownville, F. & K. & Pac. R. Co. (1883), 109 U. S. 522; New Castle Northern Ry. Co. *v.* Simpson (1884), 21 Fed. Rep. 533; Same *v.* Same (1885), 23 Fed Rep. 214. In the last case it was also held that interest on the amount found to be due at the time the work was stopped should be given as part of the compensation. The principle here announced is the same as that which underlies the rulings of the same court which permit a *quantum meruit* recovery on contracts, although invalid, because they are *ultra vires.* Pittsburgh R. Co. *v.* Keokuk & Hamilton Bridge (1889), 131 U. S. 371; Pennsylvania R. Co. *v.* St. Louis R. Co. (1886), 118 U. S. 290; Central Transportation Co. *v.* Pullman Palace Car Co. (1891), 139 U. S. 24. See especially the remarks of Mr. Justice Gray at p. 60 of the report of the last case for a statement of the grounds on which such relief is granted. The recent case of Barr *v.* New York, etc. R. Co. (1891), 125 N.Y.

A contractor to whom bonds have been issued may, under some circumstances, lose the priority of his lien by surrendering them. Thus in Fidelity Ins. Co. *v.* Shenandoah V. R. Co.[1] bonds secured by first mortgage had been issued to a construction company under its contract, and were subsequently surrendered, with an agreement that it should receive from the company second-mortgage bonds and income bonds, and that, to carry on the construction of the road, a mortgage constituting a first lien on the property should be executed to secure the new contractors.

Held, (1) that, the second mortgage never having been executed and delivered, the agreement operated as an equitable mortgage; (2) that the construction company was therefore entitled to a proper compensation for the bonds it was to have received; (3) that the old mortgage securing the surrendered bonds gave it no lien for such compensation, but that it was entitled to a lien next after that of the mortgage securing the second contractor's bond.

§ 134. **Suits to have Construction Contracts declared invalid.** — (a) *By the Company.* — As long as a contract remains executory, the maxim *in pari delicto* does not apply. Hence a construction contract which is against public policy will be rescinded, even though partially executed, at the suit of the company. Nor is it a sufficient reason for refusing to interfere, that all the shareholders, by their approval, expressly given, or by acquiescence in what has been done, under the agreement, have adopted the transaction. Even for the officers of the company who made the contract there is a *locus pœnitentiæ.*[2]

On the other hand, if the contract has been executed so that the company has received its benefits, the courts will withhold

263; s. c. 9 Ry. & Corp. L. J. 174, 26 N. E. Rep. 145, may also be consulted, the court there holding that a lessee could not hold leased property and refuse to pay rent merely because the lease was made as a part of a contract voidable because in breach of the judiciary obligations of the directors.

In Porter *v.* Bessemer Steel Co., *supra*, a case in which the priorities in the distribution of a fund arising from the sale of a road were to be determined, preference was given to the bonds of one owning most of the stock of the company, under a construction contract to complete the road, over other floating indebtedness for original construction, these bonds having passed to *bona fide* holders and having been strictly used for the purpose of completing the road. The court distinguished the case from those in which, on equitable grounds, the proceeds of the sale of the property of a railroad, as a completed structure, open for travel and transportation, are to be applied to restore earnings which, instead of having been applied to pay operating expenses and necessary repairs, have been diverted to pay interest on mortgage bonds and the improvement of the mortgaged property.

[1] 33 W. Va. 761 (1890); s. c. 11 S. E. Rep. 58.

[2] New Castle Northern Ry. Co. *v.* Simpson (1884), 21 Fed. Rep. 533.

affirmative relief. Thus where a company, through its board of directors, entered into a construction contract with certain persons, some of whom were directors of the company, and, in pursuance of such contract, issued bonds secured by a mortgage on its property, it cannot, in a suit to foreclose the mortgage, maintain a cross-bill to set it aside and cancel it as a cloud upon its title. The proper remedy in such a case was to defend against the contract on the ground of its being fraudulent, as the other parties would not be in a position to enforce it.[1]

(b) *By Individual Stockholders.* — In Thomas *v.* Brownville, Ft. Kearney, & Pac. R. Co.[2] a portion of the stockholders were allowed to intervene as defendants in a suit to foreclose a mortgage securing bonds issued in pursuance of an invalid contract.

(c) *By Judgment Creditors.* — In Mosgrove *v.* Kountze[3] judgment creditors of a railroad company filed a bill against persons, some of whom were directors of the company, for the purpose of subjecting to the payment of their judgment certain real estate acquired under a construction contract, affirmed to be void on the ground of its being contrary to public policy. No question was raised as to their right to file such a bill, the only point decided being that leave could not be granted them to file a supplemental bill for the purpose of setting up matters which might by due diligence have been ascertained and pleaded by way of amendment in the original suit.

[1] Lewis *v.* Meier (1882), 14 Fed. Rep. 311.

[2] 109 U. S. 522 (1883). (See the facts of this case in § 131, above.)

[3] 14 Fed. Rep. 315 (1882).

CHAPTER VII.

NOTICE.

§ 135. **Of what the Bond is Notice.** — Whether the rights acquired by the ownership of bonds are unqualified or not frequently depends, as in the case of other written obligations for the payment of money, upon the question whether the holder has notice of facts limiting or modifying the contract of the obligor. Broadly speaking, the rulings on this subject may be divided into two classes, — (1) those which deal with the effect of notice imparted to the holders by the contents of the bonds or mortgages themselves, and (2) those which deal with the effect of notice received or presumed to have been received from an actual or imputed knowledge of certain extrinsic facts.[1]

Bonds are notice of what appears on their face, and of anything that can be ascertained by a perusal either of the bonds themselves or of the mortgage securing them; and if the bonds and mortgage are so expressed that they lull and satisfy the inquiry, the purchaser is not bound to look any further.[2]

[1] Some of the cases cited in this chapter are cited elsewhere, but it has been thought that the grouping of these cases under the head of notice would facilitate the practitioner.

[2] Marlor *v.* Tex. & Pac. R. Co. 19 Fed. Rep. 867 (1884), Stanton *v.* Alabama & Chattanooga R. Co. (1875), 2 Woods, 523, where the purchasers were held to be affected with notice of the contents of an indorsement on the bonds. Judge Woods remarked: "Had they taken such notice, they would have seen that the Governor had indorsed them, and recited in his indorsement that he had done so in pursuance of law; that the face of the bond recited that it was one of a series of numbered bonds issued in accordance with the laws of the State, and secured by the indorsement of the Governor, affixed in pursuance of the same laws, and was a first lien upon the railroad and other property of the railroad company; and that the bonds bore the indorsement of the trustees named in the mortgage deed to the effect that they were the bonds described in and secured by said mortgage. In this instance the very bonds and mortgages which put the purchasers on inquiry lulled and stupefied inquiry."

So also a bondholder may be precluded from acquiring a priority over the other holders by the fact that the bonds gave him explicit notice of the circumstances under which the mortgage was executed, and that these circumstances were such that his lien was not entitled to any special precedence.[1]

But the rights of a purchaser are not to be affected by constructive notice unless it clearly appears that the inquiry suggested by the facts disclosed at the time of the purchase would, if fairly pursued, have resulted in the discovery of the defect existing, but hidden at the time. The purchaser of a bond in the open market and in the usual course of business is not bound to make a close and critical examination to escape the imputation of bad faith in the purchase. Thus the numbers of the bonds are not an integral part of the bonds themselves, and therefore the fact that the numbering has been changed is not, as a matter of law, notice, or even an intimation, of the larceny.[2]

Nor is a purchaser in the ordinary course of business bound to inquire into the title of his vendor merely because at the time of the sale certain certificates of scrip-preferred stock which had been fastened to the bonds by a pin have been detached from that position before the bonds are offered to him.[3]

Nor is the question of validity deemed to be raised for such a purchaser by the fact that the interest on some of the coupons has not been paid, for such a default does not dishonor either the bonds themselves or the other coupons.[4] (See also Chapter II.)

§ 136. **Of what the Mortgage is Notice.** — Where bonds expressly refer to the mortgage which secures them (as is usually the case), the two instruments must be regarded as one obligation and construed together. A purchaser of railroad bonds is bound to take notice of all statements contained in any part not only of the bonds, but also of the mortgage, whereby the promise of the obligor may be qualified.[5] (See also Chapter II.)

Thus a mortgage provision giving priority to some bondholder secured by it over other bonds of the same issue would be notice to the bondholders that they were not all on the same footing.[6]

[1] Taylor v. Atlantic & Great Western R. Co. (1878), 57 How. Pr. 26; Skiddy v. Atl., Miss. & Ohio R. Co. (1879), 3 Hughes, 320, especially p. 356.

[2] Birdsall v. Russell (1864), 29 N. Y. 220.

[3] Hotchkiss v. National Banks (1874), 21 Wall. 354, 359, affirming Hotchkiss v. Tradesman's Nat. Bank (1873), 10 Blatchf. 384.

[4] State *ex rel.* Plock v. Cobb (1879), 64 Ala. 127, 161; s. c. 7 Am. & Eng. R. R. Cas. 147.

[5] Marlor v. Tex. & Pacific R. Co. (1884), 19 Fed. Rep. 867, 869.

[6] McMurray v. Moran (1889), 134 U. S. 150, the case being here put hypothetically by Mr. Justice Harlan, *arguendo*, and disposed of as perfectly clear.

Illustrations of this principle are also found in those cases where the bonds of a certain issue recite that they are subject to the lien of a prior mortgage on the same property,[1] or to a prior equitable lien of preferred stock.[2]

So where a railroad company issues certain bonds designated "Consolidated First-Mortgage Bonds," and reference is made therein to a mortgage from which it appears that the intention was to substitute a portion of the bonds for first-mortgage bonds already issued upon the road, and to devote the remainder thereof to the extension and the completion of the line, the use of the word "consolidated" is sufficient to put a purchaser upon inquiry. Since these bonds referred to the mortgage, the purchaser was bound by the statement contained therein, and it was his duty to ascertain whether or not the holders of the old bonds were willing to make the exchange contemplated by the transaction.[3]

So also if a mortgage has been recorded in full, and its provisions require that the trustees should have an estate in fee simple in order to execute them, the record is notice that the mortgage was intended to pass a fee.[4]

§ 137. **Notice of Extrinsic Circumstances, Effect of.** — The general principle that any one dealing with a corporation is bound to take notice of the extent of its powers is applicable to the case of the purchase of bonds of one railroad company guarantied by another, but if it is within the corporate powers of the latter to guaranty bonds held in the usual course of business, the fact that the guaranty was made for a purpose not authorized by the charter will not debar a *bona fide* assignee of the company from recovering on the contract.[5] This principle is developed at greater length in Chapter II.

The circumstances from which notice is inferred may be such as should have put the purchaser of the bonds, as a prudent man, upon inquiry regarding the regularity and validity of their issue;

[1] Bronson *v.* La Crosse Railroad Co. (1862), 2 Wall. 283, 311; Coe *v.* Columbus, Piqua, & Indiana R. Co. (1859), 10 Ohio St. 372.

[2] Skiddy *v.* Atlantic, Miss. & Ohio R. Co. (1879), 3 Hughes, 320, 356 (1879).

[3] Caylus *v.* New York, Kingston, & Syracuse R. Co. (1877), 10 Hun, 295; see also Taylor *v.* Atlantic & Great Western R. Co. (1878), 57 How. Pr. 26.

[4] Randolph *v.* New Jersey West Line R. Co. (1877), 28 N. J. Eq. 49.

[5] Madison R. Co. *v.* Norwich San. Soc. 24 Ind. 457, citing with approval the ruling of Chancellor Walworth in Stoney *v.* American Life Ins. Co. (1845), 11 Paige Ch. 635, that the negotiable security of a corporation which upon its face appears to have been duly issued by such corporation, and in conformity, is valid in the hands of a *bona fide* holder thereof without notice, although such security was in fact issued for a purpose and at a place not authorized by the charter of the company, and is in violation of the laws of the State where it was actually issued.

as where the trustee whose proper functions and duty are not to deal with purchasers, but to act for the bondholders and to enforce their security, sells the bonds, and even sells them for a very inadequate price.[1]

So far as the application of this rule is concerned, it can of course make no difference that the lien so recognized is an equitable one merely.[2]

Other cases are controlled by more special considerations, as where a company induced a bank to buy its bonds by agreeing that they would be issued only to a certain amount on each mile of the constructed road. Here it was held that the lien of persons taking any bonds subsequently issued in violation of this agreement must be declared inferior to the lien of the bank, if they had notice of the agreement; but that the holders of such bonds without notice of it, whether taking them originally from the company or by purchase from one who took with knowledge, were entitled to share with the bank in the distribution of the proceeds of the foreclosure sale.[3]

In Blair *v.* St. Louis R. Co.[4] it was argued that the doctrine of constructive notice should be applied to cases in which an inspection of the corporate records would have disclosed the existence of facts constituting a prior equity against the company; but this contention did not prevail.

§ 138. **Statutes relating to the Bonds or Mortgages which Bondholders are presumed to have Notice of.** — But *bona fide* holders have, on the other hand, a right to presume that all the precedent requirements of a statute authorizing the indorsement of the bonds they hold have been complied with, and that if the statute authorizes the indorsement of first-mortgage bonds, there are no prior liens on the property. Under such circumstances they cannot be charged with constructive notice that the bonds thus indorsed were not first-mortgage bonds.[5]

On analogous principles it is held that a bondholder cannot procure the rescission of a contract for the exchange of unpaid coupons for the preferred stock of a railroad company on the ground of fraud, where the only facts alleged are that the company had no authority to issue such stock, and that, if it had such authority, the certificates were invalid for want of the common

[1] Riggs *v.* Pennsylvania, etc. R. Co. (1883), 16 Fed Rep. 804, 809.

[2] Stanton *v.* Alabama & Chattanooga R. Co. (1875), 2 Woods, 523.

[3] McMurray *v.* Moran (1889), 134 U.S. 150.

[4] 25 Fed. Rep. 684 (1885).

[5] Young *v.* Montgomery R. Co. (1875), 2 Woods, 606.

seal of the company. Such question depends on the general statutes of the State or the charter of the company.

Since the provisions of a statute regulating any given transaction are regarded as an integral part of it, the existence of any enactments which make the validity of the bond dependent upon the doing of some particular thing in a specified manner (as in this case the attaching of the common seal of the company) must be reckoned among those extrinsic facts and circumstances of which a bondholder is presumed to have notice.[1]

Thus if a company has been granted the power to mortgage its property subject to the State's right of forfeiture in case the road is not completed at a certain date, every purchaser of the bonds issued under the authority of the act must, at his peril, take notice of this restriction,[2] so far as that law imposes restrictions upon the powers of the corporation, the general rule being that, even in the case of negotiable instruments, a party contracting with an agent must inquire into his authority, since a corporation is bound only when its agents keep within the limits of their authority.[3]

A void statute, however, is not constructive notice of anything to anybody.[4]

So also the mortgagees under a mortgage made after the passage of two acts, one charging the earnings of a railroad with a lien in favor of a county in case it should avail itself of the power granted by the same act of lending money to the company, and the other reciting that the loan was then unpaid, are affected with notice of the existence of this prior lien.[5]

The same principle holds in regard to a special act fixing upon the property an earlier lien than the mortgage securing the bonds, or regulating the manner in which the bonds are to be indorsed by the State.[6]

The priority of the lien of bonds may also be made to depend on the knowledge imputed to holders respecting the functions and duties of railroad companies as *quasi* public corporations. This

[1] Coddington *v.* Railroad Co. (1880), 103 U. S. 409.

[2] Silliman *v.* Fredericksburg, Orange, & Charlottesville R. Co. (1876), 27 Gratt. 119, citing with approval Gould *v.* Town of Sterling (1861), 23 N. Y. 456, and the Floyd Acceptances Case (1868), 7 Wall. 666, 680.

[3] Silliman *v.* Fredericksburg, Orange, & Charlottesville R. Co. (1876), 27 Gratt. 119, cited in Zabriskie *v.* Cleveland, Col. & Cincinnati R. Co. (1859), 23 How. 381.

[4] Young *v.* Montgomery & Eufaula R. Co. (1875), 2 Woods, 606.

[5] Ketchum *v.* Pacific R. Co. (1877), 4 Dill. 78.

[6] Ketchum *v.* Pacific R. Co. (1877), 4 Dill. 78; State *ex rel.* Plock *v.* Cobb (1879), 64 Ala. 127; s. c. 7 Am. & Eng. R. R. Cas. 147.

was the basis of the ruling in Douglass *v.* Cline,[1] in which case wages of employees were given a preference over the claims of bondholders in the distribution of proceeds of a foreclosure sale. Bondholders, it has been said, accept their securities with knowledge that the railroad company, though technically a private corporation, is under obligation to the State to render certain important public services. They know that the railroads are in a certain sense public highways, and that whoever holds them in pledge is bound to see that they are at all times to operate as to observe the public interest.[2]

§ 139. **Notice under Recording Statutes.** — Bondholders are affected with notice of any adverse claims evidenced by a writing which is entitled to record under the laws of the State in which the debtor corporation was organized.[3]

A deed of trust is such a writing under the laws of Georgia,[4] and presumably of other States also.

This rule is, of course, to be taken subject to the limitation that the registry of such a deed is not of itself notice to parties subsequently dealing with the mortgaged property, unless it is executed in such a manner as to entitle it to be recorded.[5]

As a result of the registration laws, the bondholders under subsequent mortgages have implied notice of the rights and statutory remedies of the beneficiaries of older mortgages and deeds of trust.[6]

And if the prior mortgage is not properly acknowledged, the later mortgages will, nevertheless, be postponed to earlier, if the junior mortgage is expressly made subject to the prior one.[7]

The same consequence follows if the junior mortgagee has actual knowledge of the existence of the prior mortgage, even if it has not been so acknowledged as to be entitled to record; [8] or actual knowledge of an agreement, whereby the company stipulated with a bank, as part of the consideration for the latter's acquisition of its bonds, that it would issue bonds only to a certain amount for each mile of its constructed road.[9]

1 12 Bush, 608 (1876).

2 This and similar preferences are discussed at length in Chap. XXVIII., *post.*

3 Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush, 673; Coe *v.* Columbus, Piqua, & Indiana R. Co. (1859), 10 Ohio St. 372.

4 Branch *v.* Atlantic & Gulf R. Co. (1879), 3 Woods, 481.

5 Branch *v.* Atlantic & Gulf R. Co. (1879), 3 Woods, 481.

6 Newport & Covington Bridge Co. *v.* Douglass (1877), 12 Bush, 673.

7 Coe *v.* Columbus, Piqua, & Ind. R. Co. (1859), 10 Ohio St. 372; Bronson *v.* La Crosse Railroad (1863), 21 Wall. 283, 311.

8 Willink *v.* Morris Canal & Banking Co. (1843), 4 N. J. Eq. 377.

9 McMurray *v.* Moran (1889), 134 U. S. 150. In this case the parties taking bonds subsequently issued in violation of the

The State is not prejudiced by the non-registration of a mortgage executed in pursuance of a statute to secure a loan by it. In such a case the statute is notice to all the world that the property is subject to the lien of the mortgagee.[1]

agreement, and having notice thereof, were held entitled to share in the proceeds of a forecloaure aale only after the funds had been applied to the bonds held by the bank. Those taking bonds without notice of the agreement were placed on an equal footing with the bank.

[1] Memphis & Little Rock R. Co. *v.* State (1881), 37 Ark. 632. A statute authorized the issue of aid bonds to the C. & T. R. Co., and provided that no part of the bonds ahould be issued until the company signified its acceptance by filing a receipt therefor with the secretary of state, and that, when recorded in the office of that functionary, each certificate should be a mortgage on the road. It was held that all persons claiming under a deed of trust executed by the company under the powers conferred by a previous act, the said deed reciting that it was subject to the lien of the State created under the later act, took subject to all the certificates previously filed with the secretary of state, although the statutory mortgage had not been recorded in the counties in which the company's lands were situated. Wilson *v.* Beckwith (1893), 117 Mo. 61; s. c. 22 S. W. Rep. 639.

CHAPTER VIII.

MORTGAGES AND THEIR VALIDITY.

General Statement. — The validity of a corporate mortgage may be considered with reference (1) to the capacity of the company to execute it, or (2) to the circumstances and objects of its execution. A corporation being the creature of the legislature, the question of its capacity to execute any given mortgage is necessarily dependent upon the laws, whether general or special, under which it has been organized. Assuming a corporation to have the legal power to mortgage, there may be circumstances raising a question as to the enforceability of the particular mortgage. These circumstances may be such as might arise in the case of a mortgage by a natural person, or such as arise from the peculiar limitations which the artificial constitution of a corporate body imposes upon it.

ARTICLE I. — VALIDITY AS DEPENDENT ON THE POWER TO EXECUTE THE MORTGAGE.

A. *Mortgages of Corporate Property generally.*

§ 140. **Common-law Power to mortgage all Corporate Property.** — The general rule as to the extent of the common-law power of a corporation to alienate its property is thus succinctly stated by Chancellor Kent: "Independent of positive law, all corporations have the absolute *jus disponendi* of lands and chattels, neither

limited as to objects nor circumscribed as to quality. They may execute a mortgage to secure a debt."[1]

The application of this rule to railway companies has been repeatedly recognized. "It is now to be regarded as settled beyond any proper ground of question that a corporation may contract debts necessary for the accomplishment of the purposes of its creation, and may give valid security for their payment by pledge or mortgages of any property or interests in property that are subject to its disposal, by virtue of the implied power existing in it, and without any express provisions of statute to that effect, provided it be not restricted by statute in this respect."[2]

"Corporations created for the construction of railroads, in the absence of limitation or restraint by statute, have power at common law to borrow money and to make bills, bonds, and promissory notes for its repayment, and may mortgage their real and personal property to secure debts thus created."[3]

"There is no doubt that such a corporation, like any other trading company, may convey, either absolutely or upon condition, all property which it is authorized to hold, or which is essential to carrying on the business for which it was designed."[4]

"Generally corporations have the power at common law to sell and convey their property as they think proper. The power of a corporation to sell and convey its property, and to borrow money, and to make contracts, implies power to mortgage its property, real or personal, to secure the payment of its debts."[5]

[1] 2 Kent's Comm. 281. See note Law Rep. Ann. 142; 32 Can. L. J. N. S. 167.

[2] Miller *v.* Rutland & Washington R. Co. (1863), 36 Vt. 452.

[3] Kelly *v.* Trustees, etc. (1877), 58 Ala. 489; 21 Am. Ry. Rep. 138; followed in Sav. & Memphis R. Co. *v.* Lancaster (1878), 62 Ala. 555. See also Bickford *v.* Grand Junction Ry. Co., 1 S. C. Rep. (Can.) 696; followed in Charlebois *v.* Great North West Cent. Ry. Co. (1892), 9 Man. 1; Win. & H. B. Co. *v.* Mann, 7 Man. 81; Robison *v.* Coal Cliff Co., 12 New South Wales L. R. Eq. 293; Haley *v.* Halifax Street Ry. Co., 25 Nova Scotia L. R. 140; Thompson *v.* Erie R. Co., 11 Abb. Pr. N. S. 188. See note 26 Am. & Eng. R. R. Cas. 661; Comm. Bank *v.* Great Western R. Co., 13 L. T. 105.

[4] McAllister *v.* Plant (1876), 54 Miss. 106; s. c. 17 Am. Ry. Rep. 389.

[5] Richards *v.* Merrimack & Connecticut River Railroad (1862), 44 N. H. 127. "These principles," added the court, "are regarded as so well settled by authority and by the common sentiment of the community as to require no discussion" The following cases were cited: Gordon *v.* Preston (1833), 1 Watts, 385; Teadwell *v.* Salisbury Mfg. Co. (1856), 7 Gray, 393, 404; Haxtun *v.* Bishop (1829), 3 Wend. 13; De Ruyter *v.* St. Peter's Church (1848), 3 Barb. Ch. 119, 124; 3 Comst. 238, 240 (1849); Despatch Line of Packets Co. *v.* Bellamy Manufg. Co. (1841), 12 N. H. 205; Pierce *v.* Emery (1856), 32 N. H. 484; Jackson *v.* Brown (1830), 5 Wend. 590, 594. See also Susquehanna Bridge & Bank Co. *v.* General Ins. Co. (1852), 3 Md. 305, and Grinnell *v.* Trustees, etc. (Ohio Ct. of Common Pleas), 2 Redf. Law of Railways, 497, as to the point that the power of a corporation to borrow money carries with it, as an inci-

A corporation *de facto* can make any contracts, including mortgages of future-acquired property, which the law authorizes corporations to make.[1]

§ 141. **Common-law Power to mortgage when implied from Statutory Powers.** — The power to mortgage corporate property will, of course, be still more strongly implied if the legislature bestows upon the corporation, in addition to the ordinary powers which such bodies are usually endowed with, the right to effect such a disposition of their property, or to enter into such contracts regarding it, that the intention to permit a mortgage or pledge of the property is a natural and reasonable inference. Thus the power to sell ordinarily includes the power to mortgage.[2]

It has, however, been held in Illinois that this doctrine is not applicable to stock subscriptions, especially if the statute conferring the right to mortgage corporate property enumerates several kinds of property, and omits such securities from the list. Hence, although a railroad company may assign a claim for unpaid stock

dent, and without an express grant in its charter, the power to secure the loan by a mortgage.

In view of these authorities the statement of the Illinois court, that "it would seem the power of a corporation to mortgage its real estate might be regarded as a necessary incident to the power to acquire and hold real estate," is needlessly cautious. See Agricultural Society *v.* Paddock (1875), 80 Ill. 263; West *v.* Madison County Agri. Board (1876), 82 Ill. 205; see article in 19 Am. L. Rev. 440 (1885), on "The Power of a Railroad Company to mortgage its Property and Franchises." See article on "Railroad Mortgages of Future-acquired Property," annotated case by Redfield, 3 Am. L. Reg. N. S. 18. See article on "Railroad Mortgages — to the State or Individuals, Validity of," in 28 Alb. L. Jour. 92. See article on "Conveyances of Franchises by Railroad Companies," in 20 L. Reg. 301, 361. On power to issue debentures in England, see note at end of this chapter.

[1] McTighe *v.* Macon Construction Co. (1893), 94 Ga. 306; s. c. 21 S. E. Rep. 701.

[2] McAllister *v.* Plant (1876), 54 Miss. 106; 17 Am. Ry. Rep. 389; Branch *v.* Atl. & Gulf R. Co. (1879), 3 Woods, 481; Hendee *v.* Pinkerton (1867), 14 Allen, 381. In the last-mentioned case the court said (p. 386): "We entertain no doubt that the Grand Junction Railroad and Depot Company could lawfully sell and convey the lands embraced in this bill. They were not acquired to enable the corporation to carry on the business which it was chartered to do for the benefit of the public, nor needed or used for that purpose. Their alienation in no wise impaired or affected the usefulness of the company as a railroad, or its ability to exercise any of its corporate franchises. In the absence of any express or implied legislative prohibition, this corporation possessed all the ordinary rights of ownership over these lands, and could convey them away absolutely, or mortgage them to secure any valid indebtedness. The recent cases in which railroad mortgages have been adjudged invalid by this court do not countenance any doubt of the power of a railroad company to sell and convey whatever property it may hold, not acquired under the delegated right of eminent domain, or so connected with the franchise to operate and manage a railroad that the alienation would tend to disable the corporation from performing the public duties imposed upon it, in consideration of which its chartered privileges have been conferred."

subscriptions, like any other *chose in action*, they cannot be mortgaged.[1]

A power to execute "such securities in amount and kind" as the company may deem expedient has been held to authorize a mortgage of the entire road, with its franchises and all its property, including all future acquisitions for the use of its road.[2]

§ 142. **Common-law Power to mortgage when limited by Implication.** — The power of a corporation to alienate its property is sometimes said to be plenary, except in so far as it is limited by express legislation. This way of stating the rule, however, is not strictly correct. Ordinarily, it is true, an intention to restrict the *jus disponendi* will not be ascribed, by implication, to the legislature. Thus the fact that the charter contains a clause providing that the shares shall not be assessed over one hundred dollars, and that, if more money is necessary, it shall be raised by the creation of new shares, will not curtail the power to mortgage.[3]

But the inference drawn will be just the opposite wherever the exercise of the right of alienation would be incompatible with the attainment of the objects for which the corporate franchises were bestowed. It is well settled, therefore, that this right is limited by the purposes for which the corporation is created, and the nature of the duties and liabilities imposed by its charter.[4]

This principle is applied, in the case of railway companies and other *quasi* public corporations, to property which is essential for the performance of the duties owed to the State, or, as it is sometimes expressed, for the exercise of its franchises.[5]

Such property, it is universally held, cannot without legislative authority be alienated either voluntarily or by a forced sale.[6]

[1] Morris *v.* Cheney (1869), 51 Ill. 451. "The purpose of the mortgage," said the court, "was to enable the company to raise money to build and equip the road. Would it not, then, be a frustration of the object if they should sell their cash means?"

In England, however, a mortgage of unpaid-up capital is valid, provided the power is reserved by apt language in the articles of association. *Re* Pyle Works (C. A.), L. R. 44 Ch. D. 534 (1890). The point emphasized by the Illinois court does not seem to have been relied upon either in the argument of counsel or by the Lords Justices. See also Ansted *v.* Land Co. of Australia (1893), 14 New South Wales L. R. Eq. 330; *In re* Anglo-Australian Investment Finance & Land Co. (Lim.), 1895, 16 New South Wales L. R. Eq. 38. See § 155, *post*.

[2] Pierce *v.* Milwaukee R. Co. (1869), 24 Wis. 551.

[3] Richards *v.* Merrimack & Connecticut River Railroad (1862), 44 N. H. 127.

[4] Treadwell *v.* Salisbury Mfg. Co. (1856), 7 Gray, 393, 401; Commonwealth *v.* Smith (1865), 10 Allen, 448.

[5] Richards *v.* Merrimack & Connecticut River Railroad (1862), 44 N. H. 127.

[6] Coe *v.* Columbus, Piqua, & Indiana R. Co. (1859), 10 Ohio St. 372; Youngman *v.* Elmira & Williamsport R. Co. (1874), 65 Pa. St. 278, 286; Western Pennsylvania R. Co. *v.* Johnston (1868), 59 Pa. St. 290, 294; Leedom *v.* Plymouth R. Co. (1843), 5 Watts & Serg. 265;

In determining the practical effect of this principle, the courts have drawn some distinctions which appear to be scarcely justifiable on logical grounds. The alienability of such property has usually been discussed in connection with the validity of execution sales, and the courts have very generally assumed that the protection of the rule is confined to the real estate and fixtures of the corporation. While, therefore, the rolling-stock of a railroad, when not in actual use, is liable to execution,[1] even if it is covered by a mortgage,[2] it is held in many States that the road-bed and fixtures of a railroad company or a turnpike company, the canal and appurtenances of a canal company, the market-house of one holding a market franchise, and the plant of a water company cannot be levied upon, unless the legislature has provided.[3]

If the interest which the public has in the discharge of the duties undertaken by the corporation is the foundation of the doctrine as to the inalienability of a portion of the corporate property, it is difficult to see any valid reason why the road-bed and rails should be protected, and the cars, without which the road-bed and rails are of no utility whatever, should be subject to execution. Both rolling-stock and track are indispensable agencies in the work of transportation, which is the special function of a railroad, one not being more indispensable than the other. There would seem, therefore, to be much inconsistency in placing them in dif-

Hendee *v.* Pinkerton (1867), 14 Allen, 381; Richards *v.* Merrimack & Connecticut River Railroad (1862), 44 N. H. 127; Susquehanna Canal Co. *v.* Bonham (1845), 9 Watts & Serg. 27; Gue *v.* Tidewater Canal Co. (1860), 24 How. 257; Black *v.* Delaware & Raritan Canal Co. (1871), 22 N. J. Eq. 130, 399; Central Transportation Co. *v.* Pullman Palace Car Co. (1891), 139 U. S. 24; Ammant *v.* New Alexandria Turnpike Co. (1825), 13 Serg. & Rawle, 210; Winchester Turnpike Co. *v.* Vimont (1883), 5 B. Mon. 1; Steiner's App. (1856), 27 Pa. St. 313; Foster *v.* Fowler (1868), 60 Pa. St. 27; City of Palestine *v.* Barnes (1878), 50 Tex. 538.

1 Boston, Concord, & Montreal R. *v.* Gilmore (1858), 37 N. H. 410.

2 Coe *v.* Columbus, Piqua, & Indiana R. Co. (1859), 10 Ohio St. 372; Union Trust Co. *v.* Morrison (1888), 125 U. S. 591; s. c. 33 Am. & Eng. R. R. Cas. 33. But, of course, the execution sale is made subject to the mortgage. See *post.*

3 Plymouth R. Co. *v.* Colwell (1861), 39 Pa. St. 337; Western Pennsylvania R. Co. *v.* Johnston (1868), 59 Pa. St. 290, 294; Coe *v.* Columbus, Piqua, & Indianapolis R. Co. (1859), 10 Ohio St. 372; Youngman *v.* Elmira & Williamsport R. Co. (1874), 65 Pa. St. 278, 286; Leedom *v.* Plymouth R. Co. (1843), 5 Watts & Serg. 265; Ammant *v.* New Alexandria Turnpike Co. (1825), 13 Serg. & Rawle, 210; Winchester Turnpike Co. *v.* Vimont (1844), 5 B. Monr. 1; Steiner's App. (1856), 27 Pa. St. 313; Baxter *v.* Nashville Turnpike Co. (1882), 10 Lea, 488; Gue *v.* Tidewater Canal Co. (1860), 24 How. 257; Susquehanna Canal Co. *v.* Bouham (1845), 9 Watts & Serg. 27; City of Palestine *v.* Barnes (1878), 50 Tex. 538; Louisville Water Co. *v.* Hamilton (1883), 81 Ky. 517. But an abandoned road-bed, not in use for any purpose of public service, is not exempt from execution. Benedict *v.* Heineberg (1870), 43 Vt. 231.

ferent categories as regards their liability to be appropriated to pay the debts of the corporation. The theory that the line which divides property susceptible of a voluntary or forced alienation from property not susceptible of such alienation is identical with that which divides realty from personalty, involves the assumption that the personalty of a railroad is not indispensable to the exercise of its franchises, and such an assumption evidently begs the very question at issue. The practical importance of the subject, however, is much diminished both in consequence of the comprehensive legislation by which the disposition of railroad property is now regulated in the various States, and also by reason of the fact that, as the personal property of railroad companies is almost invariably subject to the lien of a mortgage, the right to levy upon it is now most commonly discussed with reference to the protective effect of the "after-acquired property" clause, and not with reference to its indispensability or otherwise for the exercise of the corporate franchises.

§ 143. **General Implications from Express Grants of Power to mortgage.** — A railroad company having a general express power to mortgage its road may mortgage any part of it,[1] or any extensions which may subsequently be constructed, no fresh legislative authority being necessary in this case to supplement the general grant of power.[2]

So also it has been held that the grant of a power to mortgage "property and income" confers a power which is plenary as regards both real and personal property.[3]

If the power conferred is to mortgage the corporate property to secure a debt incurred by the borrowing of money to complete and operate a railroad, an already existing debt incurred for that purpose may be secured by such a mortgage.[4]

A corporation of one State clothed with authority by the statutes of that State to mortgage its property carries that power into every State in which it owns property, and a mortgage of such property by the corporation in any State will be valid unless there is some special provision in laws of the latter State to prohibit it.[5]

[1] Pullan *v.* Cin. & Chicago Air Line R. Co. (1865), 4 Biss. 35.

[2] Gloninger *v.* Pittsburg & Connellsville R. Co. (1890), 139 Pa. St. 13; s. c. 21 Atl. Rep. 497. See also Hendee *v.* Pinkerton, 14 Allen (Mass.), 381.

[3] Covey *v.* Pittsburg & Connellsville R. Co. (1858), 3 Phil. 173.

[4] Duncomb *v.* New York, Housatonic, & Northern R. Co. (1881), 84 N. Y. 190; Greensburgh, Milford, & Hope Turnpike Co. *v.* McCormick (1873), 45 Ind. 239.

[5] American Water Works Co. of Illinois *et al.* *v.* Farmers' Loan & Trust Co. (1896), 73 Fed. Rep. 956. The New York act of 1864 (ch. 517, as amended by the

§ 144. **Implications from Grant of Power to mortgage for a Particular Purpose.** — Whether a grant of authority to mortgage railroad property for a particular purpose is to be construed as restricting the power of the company to that extent depends upon whether the grant purports to augment its common-law powers, or is merely declaratory of the common law in regard to one of the purposes for which a corporation is deemed to be capable of pledging its property. Thus it has been held that where a company is authorized to "borrow money . . . and to pledge the property to pay such loans," there is nothing to induce the supposition that the legislature intends to take away the general power of the corporation to create liens for any other purpose. As regards the exercise of that general power, the mode in which the debt is created is quite immaterial.[1]

On the other hand, a provision in the charter of a Tennessee railroad company allowing it to "increase its capital to a sum sufficient to complete its road and to stock it with everything necessary to give it full operation and effect, either by opening books for new stock or by borrowing money on the credit of the company and on the mortgage of its charter and works," has been held to give only the limited power to the company to issue bonds and mortgage its property to complete and equip its road, and for no other purpose.[2]

These cases are, it will be observed, fairly reconcilable on the ground that the Alabama court was virtually asked to recognize the doctrine that the general power of a corporation to mortgage its property may be restricted by implication, — a doctrine which, as we have seen, is not countenanced by the authorities, except in regard to property essential to the exercise of its franchises, — while the Tennesee court was dealing with a charter which granted, for certain specified purposes, a power unknown to the common law, and was therefore applying a perfectly familiar principle of statutory construction in holding that, as the power in question originated with the statute, it ought not to be extended beyond the express provisions of that statute.[3]

act of 1871, ch. 481), authorizing manufacturing corporations to mortgage their property to secure the payment of any debt which may be contracted by it in its business, authorizes it to execute a mortgage to secure not only antecedent debts, but debts contracted at the time the security is given. Lord *v.* Yonkers Fuel Gas Co. (1885), 99 N. Y. 547; s. c. 2 N. E. Rep. 909. This act is also construed in Astor *v.* Westchester Gas Light Co. (1884), 33 Hun, 333.

[1] Allen *v.* Montgomery & West Point R. Co. (1847), 11 Ala. 437, approved in Mobile & Cedar Point R. Co. *v.* Talman (1849), 15 Ala. 472.

[2] Frazier *v.* Railway Co. (1889), 88 Tenn. 138; s. c. 12 S. W. Rep. 537.

[3] Sutherland on Statutory Construction, § 325.

Where the provision in a charter which confers the power to borrow money and secure the loan by a mortgage is couched in unqualified language, the fact that the charter contains another provision, authorizing the building of a certain extension, does not warrant the conclusion that the power to mortgage is to be exercised only for the purpose of procuring money to build that extension.[1]

§ 145. **Power to execute Mortgage implies Power to insert Provisions for enforcing it.** — A company empowered to pledge its income has an implied authority to insert in the mortgage a stipulation that the mortgagee may take possession and receive the earnings, since, without such action, the pledge could not be made effectual.[2]

On similar grounds it is held that the legislature, in giving authority to a corporation to execute a mortgage, intends to invest the mortgagee with all the power and authority incident to an instrument of that kind, and that, although no express authority is given by the statute to sell the premises by virtue of the mortgage, a power of sale is to be inferred from the authority to mortgage.[3]

§ 146. **Power to mortgage not restricted by Statute declaring Lien in Favor of State.** — A statute by which the State, upon indorsing the bonds of a railroad company, obtains a lien upon the property of such company prior to all other liens cannot be construed as forbidding the creation of a lien, by mortgage or otherwise, in favor of the bondholders, to coexist with the lien of the State, nor as operating to restrain or abrogate the power which the company would otherwise have to execute a mortgage as a security for the payment of its bonds.[4]

§ 147. **Power of Consolidated Companies to mortgage their Property.** — The general rule is that the power to mortgage possessed by a company formed by the legally consummated consolidation of two companies, organized under the laws of different States, is coextensive with the powers possessed by the constituent companies before the consolidation, under the laws of their respective States.[5]

To ascertain whether the consolidation is valid, reference must be had to the laws of those States.[6]

[1] Brown *v.* Maryland & Annapolis & Elkton R. Co., 62 Md. 439.

[2] Seibert *v.* Minneapolis & St. Louis Ry. Co. (1893), 52 Minn. 246; s. c. 53 N. W. Rep. 1151.

[3] Willink *v.* Morris Canal & Bkg. Co. (1843), 4 N. J. Eq. 377.

[4] Kelly *v.* Trustees, etc. (1877), 58 Ala. 489; s. c. 21 Am. Ry. Rep. 138.

[5] Mead *v.* New York, Housatonic, & Northern R. Co. (1877), 45 Conn. 199.

[6] Taylor *v.* Atlantic & Great Western R. Co. (1878), 57 How. Pr. 26.

But even if the constituent companies, in making the contract for consolidation, fail to pursue the terms of their charters, an act passed by the legislature of one of the States, for the purpose of confirming the consolidation, will have the effect of validating a subsequent mortgage on the property of the consolidated company in that State.[1] (See following section.)

As railroad companies cannot consolidate without legislative permission, the power granted to consolidated companies to make mortgages may be restricted and qualified in any manner which the legislature deems proper.[2]

Where corporations have consolidated under the statute of New Jersey, P. L. 1893, p. 121, ch. 67, authorizing domestic corporations to merge and consolidate their corporate franchises and other property, the new corporation has power to execute a corporate mortgage to secure bonds which are intended for use in paying indebtedness of the constituent corporations and securing advances of money for the use and purposes of their business.[3]

§ 148. **Legislative Ratification.** — Subsequent ratification by the legislature will have the effect of validating a mortgage which would otherwise be invalid.[4]

Such ratification will be inferred from an act authorizing the mortgage trustees to sell the road covered by the mortgage.[5]

So also if a trust mortgage is invalid in so far as it purports to convey the franchises of the road, but otherwise valid, and the legislature prior to the sale thereunder authorizes the president of the company to transfer the franchises to the purchasers, the latter will acquire a good title to the franchises by the execution of a deed in accordance with the enabling statute.[6]

So also where an instrument, purporting to be the mortgage of the company, executed prior to the passage of an act authorizing such companies to mortgage their property, but the bonds secured thereby are not issued till after the passage of that act, it

[1] Racine & Mississippi R. Co. *v.* Farmers' Loan & Trust Co. *et al.* (1868), 49 Ill. 331.

[2] Frazier *v.* East Tennessee, V. & G. Ry. Co. (1889), 88 Tenn. 138; s. c. 12 S. W. Rep. 537.

[3] Camden Safe Deposit & Trust Co. *v.* Burlington Carpet Co. *et al.* (N. J. Eq., 1895), 33 Atl. Rep. 479.

[4] Hall *v.* Sullivan Railroad Co. (1857), 21 Law Rep. 138; Graham *v.* Boston, Hartford, & Erie R. Co. (1886), 118 U. S. 161; Shaw *v.* Norfolk County Railroad Co. (1855), 5 Gray, 162; Galveston Railroad Co. *v.* Cowdrey (1870), 11 Wall. 459; Shepley *v.* Atlantic & St. Lawrence R. Co. (1867), 55 Me. 395; Racine & Mississippi R. Co. *v.* Farmers' Loan & Trust Co. (1868), 49 Ill. 331.

[5] Richards *v.* Merrimack & Connecticut River Railroad (1862), 44 N. H. 127.

[6] Hatcher *v.* Toledo, Wabash, & Weston R. Co. (1872), 62 Ill. 477; s. c. 6 Am. Ry. Rep. 405.

will be regarded as operating upon the transaction so as to cure any invalidity which arises from the want of legislative authority.[1]

B. *Power to mortgage Franchises.*

§ 149. **General Principles respecting Power to mortgage Franchises.** — Mortgages of that portion of the property of a corporation which consists in its franchises have very generally been considered to stand upon a different footing from mortgages of its other properties and rights. The great preponderance of authority is in favor of the view that franchises cannot be mortgaged without the express permission of the legislature. The fact that a mortgage contemplates, in certain contingencies, a sale of the thing mortgaged necessarily brings a mortgage of franchises within the reach of the general rule that franchises cannot be transferred without the consent of the sovereign grantor, the mode in which the transfer is sought to be effected being quite immaterial. The authorities for this general rule are very numerous, as the subjoined note shows.[2]

[1] Miller *v.* Rutland & Washington R. Co. (1863), 36 Vt. 452.

[2] Commonwealth *v.* Smith (1865), 10 Allen, 448; East Boston Freight R. Co. *v.* Eastern R. Co. (1866), 13 Allen, 422; Braslin *v.* Summerville Horse R. Co. (1888), 145 Mass. 64; s. c. 13 N. E. Rep. 65; Hendee *v.* Pinkerton (1867), 14 Allen, 381; East Boston Freight R. Co. *v.* Hubbard (1865), 10 Allen, 459; Richardson *v.* Sibley (1865), 11 Allen, 65; Troy & Rutland R. Co. *v.* Kerr (1854), 17 Barb. 581; Troy & Boston R. Co. *v.* Boston, H. T., etc. R. Co. (1881), 86 N. Y. 107; Abbott *v.* Johnstown, G. & K. Horse R. Co. (1880), 80 N. Y. 27; People *v.* Albany & Vermont R. Co. (1879), 77 N. Y. 232; Lanman *v.* Lebanon Valley R. Co. (1858), 30 Pa. St. 42; Ammant *v.* New Alexandria Turnpike Co. (1825), 13 Serg. & Rawle, 210; Bayard's Appeal (1872), 72 Pa. St. 453; Pittsburg, etc. R. Co. *v.* Alleghany Co. (1869), 63 Pa. St. 126; Roper *v.* McWhorter (1883), 77 Va. 214; Coe *v.* Columbus, Piqua, & Ind. R. Co. (1859), 10 Ohio St. 372; Black *v.* Delaware & Raritan Canal Co. (1873), 24 N. J. Eq. 455, 465; Stockton *v.* Central R. Co. *et al.* (1892), 50 N. J. Eq. 52; Randolph *v.* Larned (1876), 27 N. J. Eq. 557; Wood *v.* Truckee Turnpike Co. (1884), 24 Cal. 474; Clarke *v.* Omaha & S. W. R. Co. (1876), 4 Neb. 458; Bruffett *v.* Great Western R. Co. (1861), 25 Ill. 353; Gulf, Col. & S. F. R. Co. *v.* Morris (1887), 67 Tex. 692; James *v.* Pontiac & Grovesdale Plank Road Co. (1860), 8 Mich. 91; Ragan *v.* Aiken, 9 Lea (Tenn.), 609; Pullan *v.* Cincinnati, etc. R. Co. (1865), 4 Biss. 35; Hall *v.* Sullivan R. Co. (1857), 2 Redf. Am. Ry. Cas. 621; Gue *v.* Tidewater Canal Co. (1860), 24 How. 257; Pennsylvania R. Co. *v.* St. Louis, Alton, & T. H. R. Co. (1886), 118 U. S. 290; Stewart *v.* Jones (1867), 40 Mo. 140. In McAllister *v.* Plant (1876), 54 Miss. 106, it was doubted whether franchises could be mortgaged without legislative authority, although it had been previously decided in that State that a railroad company could not, without special authority, mortgage its franchises and the property essential to the exercise thereof. Arthur *v.* President of Commercial Bank (1848), 9 Sm. & M. 394; New Orleans, Jackson, & Great Northern R. Co. *v.* Harris (1854), 27 Miss. 517. See note 46 Am. & Eng. R. R. Cas. 661; State *v.* Morgan, 28 La. Ann. 482; Houston & Tex. Cent. R. Co. *v.* Shirley, 54 Tex. 125; Atkinson *v.* Mari-

One of the most forcible presentations of the reasons on which the rule is founded is contained in the following passage from the opinion in Commonwealth *v.* Smith,[1] in which the impossibility of finding any foundation, either of logic or public policy, for conceding the quality of assignability as to some franchises and denying it as to others is very clearly shown.

"But in the case of a railroad company, created for the express and sole purpose of constructing, owning, and managing a railroad; authorized to take land for this public purpose under the right of eminent domain; whose powers are to be exercised by officers expressly designated by statute; having public duties, the discharge of which is the leading object of its creation; required to make returns to the legislature,—there are certainly great and, in our opinion, insuperable objections to the doctrine that its franchise can be alienated, and its powers and privileges conferred by its own act upon another person or body, without authority other than that derived from the fact of its own incorporation. The franchise to be a corporation clearly cannot be transferred by any corporate body, of its own will. Such a franchise is not, in its own nature, transmissible. The power to mortgage can only be coextensive with the power to alienate absolutely, because every mortgage may become an absolute conveyance by foreclosure. And although the franchise to exist as a corporation is distinguishable from the franchises to be enjoyed and used by the corporation after its creation, yet the transfer of the latter differs essentially from the mere alienation of ordinary corporate property. The right of a railroad company to continue in being depends upon the performance of its public duties. Having once established its road, if that and its franchise of managing, using, and taking tolls or fares upon the same are alienated, its whole power to perform its most important functions is at an end. A manufacturing company may sell its mill, and buy another; but a railroad company cannot make a new railroad at its pleasure."[2]

Some courts have expressed their dissent from this doctrine in more or less unqualified terms. In Maine the theory that franchises could not be mortgaged has been thought to be "little

etta & C. R. Co., 15 Ohio St. 21; Naglee *v.* Alex. & Fred. R. Co., 83 Va. 707; s. c. 32 Am. & Eng. R. R. Cas. 401; P. & C. R. Co. *v.* Allegheny County, 63 Pa. St. 126.

[1] 10 Allen, 448 (1865).

[2] A corporation organized to supply heat to buildings through pipes laid in the public streets is an ordinary manufacturing corporation which may mortgage its property, and not a public or *quasi* public corporation which the public policy of Massachusetts prohibits from so doing. Evans *v.* Boston Heating Co. (1892), 157 Mass. 37; s. c. 31 N. E. 698.

better than practical repudiation," and to have "little to commend it, and much to condemn it,"[1] though it may be remarked that the point was not practically involved in the case in which these expressions were used, as the legislature had ratified the mortgage.

[1] Shepley v. Atlantic & St. Lawrence R. Co. (1867), 55 Me. 395. The sweeping condemnation of the common view was supported by the following reasoning: "The whole argument seems to have no greater force than this, that it is dangerous to the public interests to have the powers and privileges conferred by a railroad franchise transferred from the original corporators to a new body. But when we consider how little importance is attached to the persons of the original corporators, how soon death must, and other circumstances may, remove them from all participation in the affairs of the road, how constantly those who have the active management of it are in fact being changed, we shall see how little practical merit this argument has. At the beginning the corporators undoubtedly have a controlling influence, but afterwards the directors are elected by the stockholders, and are often changed. Is there any reason to suppose that if a mortgage should, by foreclosure, transfer the franchise to new hands, that as capable men would not be appointed to manage the road as before? Would not the bondholders be as interested and as capable of appointing suitable managers as the stockholders? Does any one fear that the public interest would not be as safe with the former as with the latter? Why, then, is it dangerous to the public interests to allow such a transfer?"

But this view was approved in a later case in the same State. Kennebec & Portland R. Co. v. Portland & Kennebec R. Co. (1871), 59 Me. 9. Much stress was there laid upon the fact that such an objection to the validity of the mortgage rested solely on public policy, and was, therefore, rather for the State, than any of the parties in interest, to raise. Upon an examination of the various enactments of the legislature in regard to railroads the court concluded that the State could not, and did not, object to the mortgage. It was also pointed out that as a statute had conferred upon the bondholders power to organize as a corporation, after foreclosure, with all the powers of the former corporation, and in effect to assume a new franchise and act under it, the question what became of the old franchise was of little practical importance. A late decision by the Maine court seems to indicate very strongly that its earlier views have been modified so as to bring them into a closer conformity with the general current of authorities. In the case of Brunswick G. L. Co. v. United Gas, etc. Co., 85 Me. 532, it was held that a *quasi* public corporation is not allowed to sell or lease its corporate powers or franchises without legislative authority, the reason assigned being the usual one, that "if they were able to do so, they might thereby disable themselves from the performance of their public duties, and thus escape from the power of the courts and of the legislature to enforce their performance."

It is true that the same case also declares the law of Maine to be that the franchise of a corporation having the right to receive tolls may be lost by an execution sale, or the foreclosure of a mortgage. But unless this doctrine is intended to be based on the existence of a statute expressly permitting these modes of transfer, — a point which the opinion does not show, — it cannot be reconciled with the opinion expressed as to the illegality of an unauthorized sale or lease. No distinction can be drawn between voluntary and involuntary transfers. "A mortgage transferring a title, which, upon the happening of a certain contingency, may be made absolute by sale or foreclosure, has the effect, as soon as it becomes of any value to secure the purpose for which it was made, to accomplish as complete a transfer of the corporate franchise and property, and the means of performing the corporate duty, as if it had been originally an outright sale." Richardson v. Sibley, 11 Allen, 65 (per Gray, J.).

Similar views have been thus expressed by another New England court: "It is assumed by the court that, if a corporation would entitle itself to the enjoyment of its franchises, it must comply with the provisions and requirements of its charter, both express and implied, so far as its duty to the public is concerned. It must act under its charter for the accomplishment of the purposes designed by it. But it is at the option of the corporation whether it will do so or not. The only remedy in favor of the public is by a proceeding to enforce a forfeiture of the charter. The corporation cannot be compelled either to make or operate a railroad. Whether it will do so or not depends on the expectation of its being a feasible and prosperous enterprise. If it should find it to be a losing undertaking, it would be likely to cease to prosecute it. If it should find or expect it to be a profitable one, it would be likely to continue its prosecution. If the corporation should, for prudential considerations, see fit to transfer to others its property, with the franchises appertaining to such property, the same motives would operate upon the assignees, and to the same intents, as upon the corporation. The assignees would hold subject to the obligations and duties to the public which rested upon the corporation, and, in order to take any benefit from the assignment, would find it necessary to answer to those obligations and duties. The same remedy would be as effectual, so far as rights depending on the franchises of the corporation were concerned, upon the assignees as upon the corporation. The assignees could no more pervert the roadway to other uses than could the corporation. They could no more turn to any other account than the operating of a railroad any of the corporate rights and privileges, than could the corporation. So far as property held in absolute title is concerned, the corporation and the assignees could equally dispose of it as they should see fit, whether such property was essential to the operating of the railroad or not. So long as the rights and privileges conferred upon the corporation should be exercised in accomplishment of the purposes for which they were conferred, there would seem to be not only no occasion, but no right, on the part of the public to interpose between the corporation and its assignees, — certainly not by way of taking a forfeiture of the charter; and, as it seems to us, equally none on the part of individuals, by way of questioning the validity of the assignment on the score of public policy.

"The idea of a particular confidence reposed in the particular persons who compose the corporation, for the service of the public interests involved in the making and operating of the proposed

railroad, seems to us altogether fanciful and theoretical. In fact, there is no such confidence. From the nature of the case there could not be. For who shall compose the corporation at any given time depends on who owns shares of the capital stock,—one set of men to-day, another to-morrow; some citizens of the State, some foreigners. The true idea is that the public relies for its assurance that its rights will be duly answered upon the fact that they must be, in order that the conferred privileges may be held and enjoyed by the corporation, of whomsoever composed; not upon any personal confidence which the legislature has in an indiscriminate body of persons,—men, women, and children, citizens and foreigners,—daily changing, who may become or cease to be stockholders at their own pleasure and without restraint."[1]

The arguments adduced in these passages are rather in the nature of reasons why the legislature should permit the transfer of franchises than a refutation of the commonly received rule. To show that that rule may, for many, or even most purposes, be practically evaded by the sale of each corporator's interest in the franchise does not prove that the rule itself does not exist, or that it should be entirely abrogated. Besides, it should be noticed that these courts have misapprehended, or at least misstated, the real foundation of the doctrine which is combated. The transfer of franchises without legislative authority is illegal, not because the charter creates a personal trust or confidence in the original members of the corporation, but because (1) the charter of a corporation is the measure of its powers, and the enumeration of these powers excludes all others; and (2) because a grant of franchises, like any other grant, creates a contract between the sovereign grantor and the corporation, *as a corporation*, by which the latter obligates itself to discharge certain functions; and this contract is necessarily violated if the corporation undertakes to deprive itself of that possession of the franchise without which performance of the contract is impossible.[2]

The relation created by a grant of franchises, therefore, is no more one of personal confidence than the relation created by any other contract, and an argument based wholly upon the theory that a grant has the effect attributed to it by the courts of Maine and Vermont is unsound.

A business corporation organized under the law of New York, ch. 611, N. Y. Laws, 1875 (now repealed), though it might at

[1] Miller *v.* Rutland & Washington R. Co., 36 Vt. 452, 491.

[2] See the leading case of Thomas *v.* Railroad Co. (1879), 101 U. S. 71.

common law mortgage its property at will the same as natural persons,[1] was subject to the restrictions of the statute, and, unless authorized by statute, could not mortgage its franchises. There was no such authority under the act of 1875.[2]

§ 150. **Franchise to be a Corporation placed by some Courts on a Different Footing from other Franchises.**—In regard to the power to mortgage franchises some courts have drawn a distinction, though not on the same grounds, between the franchise to be a corporation and other franchises. According to one view "a corporation being an artificial being, cannot transfer its own existence into another body; nor can it enable natural persons to act in its name, save as its agents, or as members of the corporation, acting in conformity with the modes required by or allowed in its charter. But the franchises to build, own, and manage a railroad, and to take tolls thereon, are not necessarily corporate rights; they are capable of existing in and being enjoyed by natural persons; and there is nothing in their nature inconsistent with their being assignable. The franchise to be a corporation, therefore, is not a subject of sale or transfer, unless the law, by some positive provision, has made it so, and pointed out the modes in which such sale and transfer may be made effectual."[3]

In Bardstown & Louisville R. Co. *v.* Metcalfe[4] a further refinement on this doctrine was introduced, and it was held that a railroad company authorized by its charter to borrow money to

[1] See Barry *v.* Merchants' Exchange Co. (1844), 1 Sandf. Ch. 280.

[2] Beebe *v.* Richmond Light, Heat, & Power Co. (1895), 13 Misc. Rep. 737; s. c. 35 N. Y. Suppl. 1, citing as authority Carpenter *v.* Black Hawk Co. (1875), 65 N. Y. 43, 50.

[3] Hall *v.* Sullivan Railroad Co. (1857), 1 Brunner Coll. Cases, 613; 21 Law Rep. 138; 11 Fed. Cas. 257 (1857). Compare Miller *v.* Rutland & Washington R. Co. (1863), 36 Vt. 452; Bank of Middlebury *v.* Edgerton (1858), 30 Vt. 182.

In the first of these cases Mr. Justice Curtis cited in support of the doctrine Comyns's Digest, "Grants," C, and Peter *v.* Kendal, 6 Barn. & C. 703. It may be fairly questioned whether either of these authorities is properly in point. In the former, franchises are merely enumerated as being among the various subjects of a grant. In other words, they "lie in grant" and not "in livery." But this rule seems to have no bearing on the question whether the party undertaking to make the grant has the *power* to do so. In Peter *v.* Kendal the controversy arose out of the lease of a ferry franchise, but there was no question as to the power to make the lease. Moreover, the franchise was held by an individual, and not by a corporation,—a circumstance which renders this case still less pertinent, if, as seems most consistent with general principles, the validity of a transfer of franchises by a corporation resolves itself in every instance into a question of the express or implied powers of that artificial body. So far as our researches extend, it does not appear that the English courts recognize the distinction made by Mr. Justice Curtis. See also the passage cited from Commonwealth *v.* Smith, § 149, *supra*, which is a weighty authority against admitting any qualification of the general rule.

[4] 4 Metc. (Ky.), 199 (1862).

complete the road, but not expressly authorized to make a mortgage on its property and franchises to secure the bonds evidencing the loan effected for that purpose, has an implied power to make such a mortgage, but cannot mortgage its corporate existence or any *prerogative* franchise conferred upon it.

Another theory has also been formulated. "The franchise to be a corporation," it is said, "is not strictly a corporate franchise," or "a franchise of the corporation" at all. It is a franchise of the individual corporators, or the natural persons who are shareholders of the capital stock, and pertains to them as such corporators; and the corporation itself, as such, in its collective capacity, or by its board of directors, has no more power to sell this franchise thus pertaining to the corporators individually than it has to sell their paid shares of capital stock.[1]

§ 151. **Existence of Power to mortgage the Corporate Existence not usually inferred.**[2] — Whatever is the essential distinction between the franchise to be a corporation and the corporate franchises, the authorities are very clear as to existence of a general rule of construction which requires the courts to lean strongly against the inference that the legislature intended in any particular instance to grant the power to mortgage the former franchise. In an early Alabama case[3] the court, in passing upon the effect of a statutory provision by which the president and directors of a company were empowered "to borrow money to carry into effect the objects of the charter, to issue certificates or other evidence of such loans,

[1] Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467, per Manning, J.; Memphis & Little Rock R. Co. *v.* Commissioners (1884), 112 U. S. 609. This doctrine is certainly not free from objections. If the franchise to be a corporation is private property in the same sense as shares of stock, why should it not be capable of transfer by the collective consent of all the parties in interest? On the other hand, if the legislature has authorized the body organized as the corporation to assign the franchise in the manner in which corporate property is usually assigned, it seems clear that the corporators must be assumed to have taken their shares of stock subject to the contingency that the franchise may in this way pass from them. Under such circumstances, the fact that the franchise is, technically speaking, their individual property, would appear to be of no importance. It may be questioned, therefore, whether, in view of this alternative, it is not preferable to fall back upon the simple principle in support of which this rather subtle theory has been enunciated; viz., that while the existence of a power to mortgage the corporate existence is never inferred except from words specially importing a grant of that power, the existence of a power to mortgage the other franchises may be deduced from the general tenor of the enactment under which the corporation has been organized. See the following section.

[2] The subject-matter of this section should be read in connection with those which deal with the question what passes to the purchasers at the foreclosure sale. See Chap. XXXVI.

[3] Allen *v.* Montgomery & West Point R. Co. (1847), 11 Ala. 437.

and to pledge the *property* of the company for the payment of such loans," considered it unnecessary for the purposes of the decision to inquire whether authority was thus granted to pledge the franchise of the corporation, in common with its other property, but at the same time considered it not unlikely that this was the intention of the legislature. The expression "franchise" as used by the court was somewhat ambiguous. If the court intended to suggest that the provision in question authorized a mortgage of the franchise to be a corporation, that view is not sustainable in the light of more recent decisions, in which the point was raised and passed upon. Thus it has been held in an oft-cited case[1] that under a power to pledge, "by mortgage or otherwise, the entire road, fixtures, and equipments, with all the appurtenances, income, and resources thereof," the company could mortgage all its franchises except that of its corporate existence. A similar ruling has been made in regard to a power to mortgage "the road, income, and other property,"[2] and a power to mortgage the company's "means," property, and effects.[3]

Nor is a mortgage of a corporate franchise validated by the fact that, in the general law to which the charter is expressly made subject, provisions are inserted requiring the class of corporations to which the mortgagor belongs to make annual reports showing, among other things, the number of mortgages on road and franchises, "and on any other property of the corporation, and the increase or decrease of mortgage debt during the year."[4]

[1] Coe *v.* Columbus, Piqua, & Ind. R. Co. (1859), 10 Ohio St. 372. In Joy *v.* Jackson Plank Road Co. (1863), 11 Mich. 150, it was held that where a mortgage was executed in pursuance of a special act, empowering a plank road company to mortgage the road and other property of the company, the franchise of taking tolls was to be understood as included with the road and its fixtures.

[2] Pullan *v.* Cincinnati & Chicago Air Line R. Co. (1865), 4 Biss. 35. In Hatcher *v.* Toledo, Wabash, & Western R. Co. (1872), 62 Ill. 477, however, it is denied that the right to mortgage the "road, property, and income" can be construed to confer the right to mortgage any of the franchises, the transfer of the franchises to the purchasers at the sale under the power in the trust deed under discussion being held effectual only because the legislature, prior to the sale, had authorized the president of the company to execute a deed for that purpose. Whether ch. 43 of Iowa Code of 1851, which gave railroad companies the power to incumber their real and personal property, implied the grant of a power to mortgage its franchise, was a question raised but not answered in Dunham *v.* Isett (1863), 15 Iowa, 284.

[3] Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467, in which case Eldridge *v.* Smith, 34 Vt. 484, is reviewed. In Alabama, however, the purchasers of a railroad are enabled by statute to constitute themselves into a body corporate, and have all the rights and franchises in respect to it with which the company was vested, and a power to sell a road. Branch Sons & Co. *v.* Atlantic & Gulf R. Co. *et al.* (1879), 3 Woods, 481.

[4] Richardson *v.* Sibley (1865), 11 Allen, 65. In this case there was the additional feature that the same statute had also

Authority to borrow money "on the credit of the company and on the mortgage of its *charter* and works" does not confer upon the company power to convey to the bondholders the franchise to be a corporation in such a sense that they will have the right to organize under the act as successor to, and substitute for, the original company.[1]

Power to mortgage the corporate franchise is necessarily implied where the company is authorized to mortgage *all* its franchises.[2]

§ 152. **Power to mortgage Franchises implied from Grant of Power to sell them.** — If the power is conferred in unqualified terms to sell the corporate franchises, the company must necessarily have the power to mortgage them.[3]

C. *Power to mortgage After-acquired Property.*[4]

§ 153. **Power expressly conferred by Statute.** — The power of a railroad company to mortgage its after-acquired property is often based upon the terms of a statute explicitly conferring that power.[5]

In Louisiana, railroad companies are specially privileged in this respect, as the prohibition of the Code of that State against mortgaging future property is levelled against private persons merely.[6]

Book debts of the company are its "property" within the meaning of a power to raise money by mortgage of any of its "property." [7]

§ 154. **Power implied from Enumeration of the Kinds of Property which may be mortgaged.** — Some decisions rest on the principle that, as a matter of verbal construction, and in view of the objects

decisively negatived the inference thus rejected by providing that no such corporation should "lease or sell its road or property, unless authorized so to do by its charter or special act of the legislature."

[1] Memphis & Little Rock R. Co. *v.* Commissioners (1884), 112 U. S. 609.

[2] First Division of St. Paul, etc. R. Co. *v.* Parcher (1869), 14 Minn. 297.

[3] Willamette R. Co. *v.* Bank of British Columbia (1886), 119 U. S. 191.

[4] For a general discussion of the question whether a chattel mortgage can cover after-acquired property, see two papers in 21 Albany L. J., pp. 227 and 346, the latter dealing mainly with the law in Mississippi.

[5] See, for example, the statutes construed in Dunham *v.* Isett (1863), 15 Iowa, 284; City of Quincy *v.* Chicago, Burlington, & Quincy R. Co. (1880), 94 Ill. 537.

[6] Bell *v.* Chicago, St. Louis, & N. O. R. Co. (1882), 34 La. Ann. 785; Parker *v.* New Orleans, B. R. & V. R. Co. (1888), 33 Fed. Rep. 693. The former case contains a full review of the statutes and case laws of Louisiana in regard to this subject. In Minnesota it is also provided that after-acquired property may be mortgaged: Stat. at Large, 1873, p. 431; and in many other States not necessary to be enumerated here.

[7] Bloomer *v.* Union Coal, etc. Co. (1873), L. R. 16 Eq. 383.

for which railroad mortgages are sanctioned, some expression which occurs in the statutory enumeration of the various things which may be mortgaged should be held to embrace future acquisitions. Thus it has been held that the use of the comprehensive term "property" in such enumeration will authorize a mortgage which purports to cover after-acquired rolling-stock and other property essential to the use of the road. Judge Sharswood stated the views of the court as follows: "But the principal contention here has been that the mortgage by this corporation, so far as it included subsequent acquisitions, was *ultra vires*, — beyond the power conferred upon them by the legislative grant. The act authorized them to mortgage all their 'property,' a word of very large extent. Property (*proprietas*) is whatever is a man's own (*proprius*). His future acquisitions, though subject to a contingency, are his own, and if, as we have seen, they can be granted or assigned, they are his present property, valuable now to him because they can be enjoyed or used by anticipation. There is no refinement in this reasoning as applied to the construction of this statute. The legislature evidently intended it. Every law is to be interpreted according to its subject-matter. This act relates to a railroad and its usual necessary appurtenances. The words are 'road, property, rights, liberties, and franchises,' including the road and its adjuncts. The very objects of the loan and of the mortgage to secure it as expressed in the act was 'for the purpose of constructing and equipping the road.' It evidently contemplated a condition of things in the future. The bare road, only then constructed in part, without any rolling-stock or equipments, would have 'been no security,' or a very inadequate one. Had the road even been fully equipped at the date of the mortgage, can it be doubted that the legislature meant that it should confine everything subsequently acquired to replace old and worn-out materials, and to maintain and keep up the equipment? No money would have been loaned on a security daily deteriorating, and which must eventually perish entirely." [1]

So also has it been held that authority to mortgage "personalty" conferred the power to mortgage personalty acquired after the execution of the mortgage.[2]

[1] Philadelphia, Wilmington, & Baltimore R. Co. *v.* Woelpper (1870), 64 Pa. St. 366.

Compare Hodder *v.* Kentucky R. Co., 7 Fed. Rep. 793, where it was held that authority to mortgage the "property, franchises," etc., of the railroad company conferred authority to mortgage after-acquired property. The court, however, does not give any reasons for its opinion, and it is not apparent upon what precise grounds the ruling was made.

[2] Williamson *v.* New Jersey Southern R. Co. (1875), 26 N. J. Eq. 398.

As the power to grant the product of property includes, by reasonable implication, the power to grant the means by which that product is brought into existence, the reasons for holding that the company may mortgage future acquisitions are stronger when it is authorized to borrow money on the security of its "property and income," than when the "property" alone is mentioned as the permissible subject-matter of the pledge.[1]

In Coe *v.* Columbus, Piqua, & Ind. R. Co.[2] the same words were construed in the same manner for the same reasons. "The pledge," said the court, "is to be of the property and income. The income intended must have been the future income, and was to have been produced by property in possession and to be acquired. If this future product can be conveyed, why not that by which it is to be created?"

And in a recent case in the Circuit Court of Appeals it was held that a railway company might, under this Ohio statute, mortgage its road and any subsequent accessions or accretions properly appurtenant thereto, whether acquired by itself or its successor in title, and whether the road, at the time the new property is acquired, is maintained by virtue of the original franchises, or of franchises newly conferred by the State. The company, therefore, may make a mortgage the lien of which will attach to a terminal depot subsequently acquired by a consolidated company formed by the several companies of which the mortgagor is one.[3]

Power to pledge the franchises and rights of the corporation includes by necessary implication the power to pledge everything that is necessary to the enjoyment of those franchises. *Cuicunque aliquis quid concedit, concedere videtur et id sine quo res ipsa esse non potuit.* A grant of such power, therefore, will render valid a mortgage of after-acquired property.[4]

[1] Ludlow *v.* Hurd (1857), 1 Disn. (Ohio) 552; Covey *v.* Pittsburg, Ft. Wayne, & Chicago R. Co. (1858), 3 Phil. 173. In the last-cited case Agnew, P. J., said: "In giving the power to borrow and pledge, it must be supposed the power was given to its fullest extent in order 'to carry into effect the objects of the incorporation.' But if any doubt remains, the power to pledge the 'income' as well as the property would banish it. Income is necessarily an after-acquisition, and is brought into existence by future efforts and the use of accruing property. It is potential and dependent. It is a fair inference that the power to pledge it includes the power to pledge future acquisitions."

[2] 10 Ohio St. 372 (1859).

The view of the Ohio court as to the effect of the statute of that State was incidentally sanctioned in Pennock *v.* Coe, 23 How. 117, where, although an express decision on this point was not rendered, for the reason that it had not been raised by counsel, the opinion was expressed that the authority to mortgage after-acquired property was ample.

[3] Compton *v.* Jesup (C. C. A., 1895), 68 Fed. Rep. 263.

[4] Phillips *v.* Winslow (1857), 18 B. Mon. (Ky.) 431.

A mortgage of a railroad not yet built, or of property not yet acquired, is not forbidden by the policy or the letter of a statute limiting the amount of bonds which may be issued and secured by mortgage to the amount of the capital actually paid in at the time of the issue.[1]

§ 155. **Power to mortgage Uncalled Capital.** — The power to mortgage uncalled capital has been discussed in numerous English cases, and the doctrine now accepted may be shortly stated as follows: Future calls are not "property of the company."[2]

For this reason a power which merely extends to the mortgage of property will not authorize a mortgage of uncalled capital.[3]

But there is nothing in the Companies Act of 1862 and its amendments which either expressly or by necessary implication prohibits a company from executing such a mortgage.[4]

The question whether the company possesses the power is merely one of the proper construction of the memorandum and articles of association.[5]

[1] Baker *v.* Guarantee T. Co. (N. J. Eq., 1895), 31 Atl. Rep. 174.

[2] Bank of South Australia *v.* Abrahams, L. R. 6 P. C. 562.

[3] Bank of South Australia *v.* Abrahams, L. R. 6 P. C. 562 (company empowered to charge property); Stanley's Case, 4 DeG., J. & S. 407 (company empowered to charge property and funds). These cases were distinguished in Howard *v.* Patent, etc. Co., L. R. 38 Ch. Div. 156 (1888), where a mortgage of future calls was held valid under a power to mortgage the "property and rights" of the company. It has been held that the existence of such a power cannot be inferred from the use of the word "effects" in addition to the word "property" in the enabling act. *In re* Sankey Brook Coal Co. (1870), L. R. 10 Eq. 381. In this case Vice-Chancellor James took the broad ground that "property" means a thing actually existing, a position which seems difficult, if not impossible, to reconcile with the opinion of the Supreme Court of Pennsylvania above referred to.

Under an assignment of "all the lands, tenements, and estates of the company, and all their undertaking," future calls, whether to be made, or already made and not yet paid, will not pass. King *v.* Marshall, 33 Beav. 565.

But the capital of the company is not covered by the lien of a debenture in which the directors pledge "the property belonging to us, with all the buildings and stock on and connected with our said property, and all the receipts and revenues to arise therefrom," and in which the debenture loan is declared to be a first charge on our undertaking and property, and receipts and revenues aforesaid." The declaration of such a charge, therefore, is not *ultra vires.* *In re* Marine Mansion Co. (1867), L. R. 4 Eq. 601.

[4] *In re* Pyle Works (1890), L. R. 44 Ch. Div. 534, per Cotton and Lindley, L.JJ.

[5] See the following cases in illustration of this rule: Stanley's Case (1864), 4 DeG., J. & S. 407; *In re* Phœnix, etc. Steel Co. (1875), 44 L. J. Ch. 683; *In re* Sankey Brook Coal Co., L. R. 9 Eq. 721; 10 Eq. 381; *In re* Colonial Trust Corporation, L. R. 15 Ch. D. 465; Bank of South Australia *v.* Abrahams, L. R. 6 P. C. 265; Howard *v.* Patent, etc. Co., 38 Ch. Div. 156; *In re* Pyle Works (1890), L. R. 44 Ch. Div. 534. The last-mentioned case contains an elaborate review of the authorities. Hulme *v.* Gold Syndicate, 13 Rep. 346; Newton *v.* Anglo-Australian Co., 72 L. T. 305; Page *v.* International Co., 68 L. T. 435; Fowler *v.* Broad's Night-Light Co., 1 Ch. 724. See § 141, *ante*, and also *In re* Streatham Co. (1897), 1 Ch. D. 15.

§ 156. **Limits of the Power to mortgage After-acquired Property.** — In some States the power to mortgage is expressly limited by the legislature, in accordance with the doctrine which will be developed below in discussing the extent of the mortgage lien; viz., that nothing is covered by an after-acquired clause couched in general terms except what is acquired for railroad purposes. Thus in Florida it is provided that a corporation may mortgage or otherwise convey such real and personal estate as the purposes of the corporation shall require, not exceeding the amount limited in the articles of incorporation, and the special statute relating to railroad mortgages enumerates, as the permissible subject-matter thereof, various kinds of property, tangible and intangible, all growing out of or used in connection with the business of transportation, and concludes with the general term "appurtenances used in connection with such railroad."[1]

But by most of the enabling statutes the company may pledge its corporate "property and franchises," a form of phraseology which, according to the doctrine of the cases cited in the last section, confers authority to mortgage any after-acquired property which the company is empowered to hold, and leaves the actual scope of the lien to be determined by the principles of construction which are illlustrated below.

A mortgage by a business corporation to a trustee, for the security of bondholders, of its real and personal property, though it purport to cover future-acquired property, will not be construed to cover personal property other than that held at the time the mortgage was executed and recorded, and such additions to it as have become part and parcel of the original articles, and incapable of a separate identification.[2]

A provision in a mortgage of a business corporation for the security of its bondholders that it covers all future-acquired property is regarded by the courts only as an executory agreement to do what is competent and necessary to give a lien upon such personal property as the corporation may afterwards acquire as it comes into existence. It has no force against subsequent liens by attachment and execution creditors or mortgagees, unless such lien be actually effected prior to their liens.[3]

§ 157. **Effect of the Want of Power to hold the Property attempted to be mortgaged.** — Such want of power may be owing to the

[1] Bush's Dig. (1872), p. 165; Laws 1874, ch. 1987, § 9, par. 10.

[2] Beebe *v.* Richmond Light, Heat, & Power Co. (1895), 13 Misc. Rep. 737; s. c. 35 N. Y. Suppl. 1.

[3] Beebe *v.* Richmond Light, Heat, & Power Co. (1895), 13 Misc. Rep. 737; s. c. 35 N. Y. Suppl. 1 (1895), citing as authority Rochester Distilling Co. *v.* Rasey (1894), 142 N. Y. 570.

absence of a direct legislative authorization. Thus where a charter empowering the company to acquire and hold such real property "as might be necessary and convenient for the construction, maintenance, and management of the road," and also to acquire "any steamboats, piers, wharves, and the appurtenances thereto belonging, that the directors may deem necessary, profitable, and convenient for the corporation to own, use, and manage in connection with said railroad," it was held that property bought of an opposition steamship line, not with a view of employing it in the business of the road, but to withdraw it from business, thereby preventing competition, was not property which the company was authorized to acquire, and therefore could not be mortgaged.[1]

So although a company whose powers, as regards the acquisition of land, are restricted to such lands as are "necessary and convenient" for the purposes of the railroad, may purchase and hold other lands temporarily, when, by doing so, they can acquire lands within the scope of their charter powers at a smaller cost than they could otherwise have been obtained, it cannot hold these surplus lands permanently, nor subject them to a mortgage which contemplates a prolonged ownership.[2]

A similar result follows if the acquisition of the property is invalid, because made without observing the conditions prescribed by the legislature for such a transaction. Hence if the company is empowered to purchase other lines, provided the purchase is assented to by a majority in value of its stockholders, the mortgage will not cover a line of railroad which was not a part of the system at the time the mortgage was executed, and was purchased without procuring the necessary concurrence of the stockholders.[3]

Even if the power to hold lands is given in general terms, a court may be justified, from a consideration of the policy of the State as disclosed by its legislation, in holding that only such lands as are necessary for railroad purposes are intended to be embraced in the power. But if by a later statute railroad companies are given the right to receive lands, without limitation as to amount, in payment of stock subscriptions, provided they are disposed of in a reasonable time, a mortgage on lands so acquired which creates a lien not inconsistent with such a statute as respects duration, amount, and purpose will be valid.[4]

[1] Morgan & Raynor, Trustees, *v.* Donovan (1877), 58 Ala. 241; s. c. 21 Am. Ry. Rep. 109 (1877).

[2] Boston & New York Air Line R. Co. *v.* Coffin (1882), 50 Conn. 150; s. c. 12 Am. & Eng. R. R. Cas. 375.

[3] Hodder *v.* Kentucky & Great Eastern R. Co. (1881), 7 Fed. Rep. 793.

[4] Taber *v.* Cincinnati, Logansport, & Chicago R. Co. (1860), 15 Ind. 459. The court in this case expressly waived the question whether a lien which did not an-

So where the company at the time of the execution of the mortgage has no power under its charter to accept a grant of lands from the United States, and no such acquisition was contemplated, the lands obtained by such a grant will not pass under the "after-acquired property clause."[1]

Similarly if a company has no power to consolidate with another at the date of the mortgage, but subsequently does so by the consent of the legislature expressly given for that purpose, the property of the second company is not covered by the after-acquired clause of the mortgage.[2]

A like rule applies to branch roads[3] or extensions[4] which the company was not authorized to build when it made the mortgage.

On the other hand, a general after-acquired clause covers a purchased road if within the chartered limits of the company;[5] and

swer the above description would have been invalid. As the existence of the mortgage would not in any way affect the power of the company to sell the land, or disable it from complying with the provisions of the statute, it is difficult to see any ground for supposing that lands acquired under such circumstances might not be subjected to every kind of lien. It surely can make no difference, so far as the policy of the statute in question is concerned, whether the company receives a part of the price of the land as an advance on the security of the mortgage, and the rest when it is sold subject to the mortgage, or receives the whole price at one time.

[1] Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467.

[2] Gibert *v.* Washington, Va. Mid. & Gt. So. R. Co. (1880), 33 Gratt. 586. The court decided this case partly on the ground stated in the text, and partly on the more general ground that the term "after-acquired property" applies only to "such necessary accretions as are requisite to keep up the road, such as new rails, cross-ties, depots, rolling-stock, machinery, and, it may be, real estate acquired for the legitimate purposes of the corporation." This limitation of the meaning of the words seems scarcely justified by the authorities. If a leasehold interest in another road will pass under the mortgage, it is difficult to see why another road acquired in full ownership should not also pass, provided the acquisition is authorized. This latter condition, it is submitted, is the only one necessary to be fulfilled in regard to such property as a purchased road.

[3] Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467.

[4] Randolph *v.* New Jersey R. Co. (1877), 28 N. J. Eq. 49; Alexandria & Fredericksburg R. Co. *v.* Graham *et al.* (1879), 31 Gratt. 769. In Randolph *v.* Wilmington & Reading R. Co., 11 Phil. 502 (U. S. C. Ct., 1876), where it was held that if a mortgage is executed of a railroad, as then made or to be made, and under authority of a subsequent act a later mortgage is executed on an extension of the original road, — the special act providing that the later mortgage should be a first lien on the extension, — a sale under the original mortgage must be exclusive of the branch. No reasons are given for this ruling, but from the statement of the case it is to be presumed that the company would have had no power to build the extension without the second statute. Under these circumstances the extension came into their hands burdened with the lien declared by the legislature, and they took it *cum onere*.

[5] Branch *v.* Jesup, 106 U. S. 468; Branch *v.* Atlantic & Gulf R. Co. (1879), 3 Woods, 481; Williamson *v.* New Jersey Southern R. Co. (1874), 25 N. J. Eq. 13.

an extension, provided its construction has been authorized either by its original charter or an act subsequently passed for that purpose at some time before the execution of the mortgage.[1]

ARTICLE II. — VALIDITY OF THE MORTGAGE AS AFFECTED BY THE MANNER AND CIRCUMSTANCES OF ITS EXECUTION.

§ 158. **Formal Requisites.**

(a) *Witnesses* are not necessary to the validity of a mortgage executed by a corporation in Connecticut, the laws of that State being sufficiently complied with where the instrument is signed by the president and sealed with the corporation seal.[2]

(b) *Oath.* — A mortgage of the personal property, if actually sworn to by the agents who executed it, is not invalid in New Hampshire, for the reason that the signatures affixed by them to the oath do not purport to have been subscribed on behalf of the corporation, provided the instrument throughout purports to be the deed of the corporation, and is executed in the corporate name.[3]

(c) *Acknowledgment.* — Under a Tennessee statute providing the following formula for the acknowledgment of deeds: "Personally appeared before me . . . the within named bargainor, with whom I am personally acquainted," etc., it has been held that where the mortgage of a Tennessee railroad company was executed in New York, and the officer taking the acknowledgment of the grantors, the president and secretary of the company, certified that each of them was "personally known" to him, a sufficient compliance with the statute was shown, the expressions "to be personally acquainted with" and "to know personally" being in such certificates regarded as equivalent phrases.[4]

(d) *Seal.* — For the general rules as to necessity of affixing the corporate seal to its written contracts the reader will refer to works on corporation law.[5]

(e) *Delivery.* — Where a mortgage has been duly executed, acknowledged, and recorded, and treated as a valid lien by the

[1] Willink *v.* Morris Canal & Bkg. Co. (1843), 4 N. J. Eq. 377.

[2] Nichols *v.* Mase (1883), 94 N. Y. 160; s. c. 17 Am. & Eng. R. R. Cas. 230.

[3] Richarda *v.* Merrimack & Connecticut River R. Co. (1862), 44 N. H. 127.

[4] Kelly *v.* Calhoun (1878), 95 U. S. 710. It was alao held in the same case that, as there was no statutory provision in Tennessee as to the execution and acknowledgment of deeds by a corporation, the officer who affixes the corporate seal to a deed is the party executing it, within the meaning of the statute requiring deeds to be acknowledged by the grantor.

[5] See Thompson Corp., §§ 5044 *et seq.* Some cases as to the authority of corporate agents to affix a seal to mortgages are cited in §§ 162, 166, *post.*

company, the fact that the trustee has not had manual possession of the instrument does not affect its validity.[1]

A mortgage given to secure bondholders does not go into operation until the bonds are delivered to the bondholders.[2]

(f) *Special Requirements.* — An affidavit of the secretary of a consolidated corporation attached to a mortgage, "that the true consideration of the above mortgage is the issue of four hundred thousand dollars ($400,000) in the bonds of the mortgagor, for the purpose specially set forth in the mortgage," has been held sufficient to relieve the mortgage from being declared void under the requirements as to an affidavit, etc., contained in Supp. Rev., N. J., p. 491, par. 11.[3]

§ 159. **When a Mortgage executed by a Corporate Agent is the Deed of the Corporation.** — A mortgage executed by the president cannot take effect as the deed of the corporation unless it was executed by or in the name of the corporation, even though the action of the president was taken in pursuance of the votes of the corporation, and the instrument was designed to take effect as its deed.[4]

But the corporation will be bound by a mortgage executed in these words: "In testimony whereof the said party of the first part have caused these presents to be signed by their president, and their common seal to be thereto affixed. A. B., President," and seal. Such an instrument purports to be the deed of the corporation to which they have caused their seal to be affixed, not to be the deed of the agent executed by him in behalf of the principal, and it therefore conveys the company's title.[5]

§ 160. **When Mortgage is not vitiated by Vagueness of its Descriptive Clause.** — An agreement construed, under the circumstances, to operate as an equitable mortgage, has been held not to be invalid for the reason that it pledged the real and personal estate of the company without specification, and did not state the amount to be secured.[6]

§ 161. **Authority of Corporate Officers generally to execute a Mortgage binding on the Corporation.** — A corporation can act only by its agents, and in order to bind the corporation the authority of the agent must appear. This need not be shown

[1] McCurdy's Appeal (1870), 65 Pa. St. 290.

[2] Wade *v.* Donau Brewing Co. (1894), 10 Wash. 284; s. c. 38 Pac. Rep. 1009.

[3] Camden Safe Deposit & Trust Co. *v.* Burlington Carpet Co. *et al.* (N. J. Eq., 1895), 33 Atl. Rep. 479.

[4] Miller *v.* Rutland & Washington R. Co. (1862), 36 Vt. 452.

[5] Haven *v.* Adams (1862), 4 Allen, 80.

[6] Mobile & Cedar Point R. Co. *v.* Talman (1849), 15 Ala. 472.

by any resolution of the board or other written evidences; it may be implied from facts and circumstances.[1] And the presumption being that such persons are rightfully in office, it is not incumbent on the party claiming under their acts, unless some evidence is offered on the subject, to show that they were properly elected.[2]

The authority to execute a mortgage of the corporate property may, as in other cases of agency, be shown either by evidence of the acts of the corporation prior to the time of the execution, or by acts subsequent to such execution from which a ratification may be inferred.[3] (See section below as to ratification.)

Where a mortgage covering property of a railroad in two States has been regularly foreclosed in a federal court of one of the States, concurred in by the federal court in the other, and regularly entered there, the court decreeing the foreclosure will not consider afterwards the question of the validity or invalidity of the mortgage.[4]

If it appears that acts like the one in question would, under ordinary circumstances, be within the authority, a presumption arises that the necessary circumstances did exist, and that the act in question was authorized.[5]

Thus where a contract purporting to be sealed with the seal of a corporation is proven to have been signed and executed by the proper agents, the presumption is that the seal was regularly affixed by the proper authority; and a contract under seal executed by an agent within the scope of his appointed power will be held valid and binding on the corporation until evidence to the contrary has been introduced.[6]

The presumption of authority to affix the seal of the corporation to a contract will not be overcome by the mere fact that no vote of the directors authorizing it is shown.[7]

[1] Northern Central R. Co. *v.* Bastian (1859), 15 Md. 494.

[2] Susquehanna Bridge & Bkg. Co. *v.* General Ins. Co. (1852), 3 Md. 305.

[3] Despatch Line of Packets *v.* Bellamy Mfg. Co. (1841), 12 N. H. 205; Cheever *v.* Rutland R. Co. (Vt., 1869), 4 Am. Ry. Rep. 291; Hervey *v.* Ill. Midl. Ry. Co. (1884), 28 Fed. Rep. 169, 175; Claflin *v.* South Car. Ry. Co. (1880), 8 Fed. Rep. 118, 135.

[4] Central Trust Co. of New York *v.* Marietta & North Ga. Ry. Co. *et al.* (Morse, Intervener) (1896), 73 Fed. Rep. 589.

[5] Martin *v.* Niagara Falls Paper Mfg. Co. (1890), 122 N. Y. 165; s. c. 25 N. E. Rep. 303; 9 Ry. & Corp. L. J. 15; Lincoln *v.* Iron Co. (1880), 103 U. S. 412; Farmers' & Mechanics' Bank *v.* Butchers' & Drovers' Bank (1857), 16 N. Y. 125.

[6] Ang. & Ames on Corp., § 224; Fidelity Ins., Trust, & Safe Deposit Co. *v.* Shenandoah Valley R. Co. (1889), 32 W. Va. 244; s. c. 9 S. E. Rep. 180; 38 Am. & Eng. R. R. Cas. 577.

[7] Waterman on Corp., § 96; Northern Central R. Co. *v.* Bastian (1859), 15 Md. 494; Fidelity Ins., Trust, & Safe Deposit Co. *v.* Shenandoah Valley R. Co. (1889), 32 W. Va. 244; s. c. 38 Am. & Eng. R. R. Cas. 577; 9 S. E. Rep. 180.

Thus the seal of a corporation may be attached to a mortgage of its property by a person recognized by its president and board of directors as its secretary, although he is not *de jure* secretary.[1]

The official acts of persons who are *de facto* officers of a corporation, and hold themselves out to the world as such, bind the corporation and all who claim under it.[2]

General Corporation Act, N. J., § 16, providing for the management of the business of corporations by directors who are shareholders, does not apply to the directors for the first year of a corporation consolidated under P. L. N. J., 1893, p. 121, ch. 67, and a mortgage of the property of the corporation executed by the directors for the first year who are not stockholders is valid.[3]

§ 162. **Authority of Individual Officers.** (a) *Directors.* — When the by-laws of a private corporation confer upon the directors power to act in behalf of such corporation, and do not put any special limitation on the manner in which that power is to be exercised, a majority of the board may act within the scope of the authority conferred, either when there is a consultation of the whole body and a concurrence of the majority, or there is a regular meeting at which all the directors might be present, and a majority are actually in attendance, and act by virtue of a note given by the majority of those present.[4]

A statute empowering the directors to "manage the affairs of the company, make and execute contracts of whatsoever kind fully and completely, to carry out the objects and purposes of the corporation in such way and manner as they think proper, and to exercise generally the corporate powers of the company," has been construed as merely declaratory of the common-law principle, though the statute also states that the company "shall have power to borrow from time to time, on the credit of the corporation, and under such regulations and restrictions as the directors thereof, by *unanimous concurrence*, may impose, such sum of money as they may deem necessary for constructing and completing their railroad."[5]

If the by-laws of a corporation provide that, in the management of its affairs, the directors shall have all the powers which the

[1] Augusta T. & G. R. Co. *v.* Kittel (1892), 52 Fed. Rep. 63; 2 C. C. A. 615. See Davies *v.* Bolton & Co., 3 Ch. 679.

[2] Porter *v.* Pittsburg Bessemer Steel Co. (1886), 120 U. S. 649.

[3] Camden Safe Deposit & Trust Co. *v.* Burlington Carpet Co. *et al.* (N. J. Eq., 1895), 33 Atl. Rep. 479.

[4] Despatch Line of Packets *v.* Bellamy Manufg. Co. (1841), 12 N. H. 205. The transaction discussed in this case was a mortgage.

[5] McLane *v.* Placerville & Sacramento Valley R. Co. (1885), 66 Cal. 606; s. c. 6 Pac. Rep. 748; 26 Am. & Eng. R. R. Cas. 404.

corporation itself possess not incompatible with the provisions of the by-laws and the laws of the Commonwealth, and there is nothing in the by-laws incompatible with the exercise by the directors of the power to borrow money, issue bonds, or convey in mortgage the bonds of the corporation as security therefor, the directors may exercise such power.[1]

The effect of a section of a charter which places full power in the board of directors to manage the property, business, and affairs of the company, and authorizes the issue and sale of the coupon bonds and the execution of a mortgage or deed of trust to secure their prompt payment, is not restricted by the fact that the directors could do certain other things only with the consent of the stockholders.[2]

The original charter of an Alabama railroad company authorized the borrowing of money and the execution of a mortgage to secure the loan by a majority vote of the board of directors, the number of that board being fixed at nine members. By an amendment to the charter, the number of the members was afterwards changed to eleven, inclusive of the president. The powers of the board were to be the same as under the original charter, but it was provided that six members should constitute a quorum. It was contended that a mortgage executed by six members, in the absence of the president, was not valid; but the court held that the mention of the president in the amended charter must be construed to mean that he, if present, would make one of the six constituting the quorum, and not that he was thereby made an integral part of the corporation, without whose presence it was impossible to complete the quorum. The mortgage was therefore sustained.[3]

Under the provisions of the Arkansas statute (Mansf. Dig., §§ 964, 969) providing that the business of a corporation must be transacted by a majority of its directors convened according to its by-laws, a mortgage for past indebtedness and for a present loan executed by a majority of the directors at a special meeting is void, where the by-laws of the corporation contain no provision for a special meeting, and one of the directors temporarily absent from the State had no actual notice of the meeting.[4]

[1] Hendee *v.* Pinkerton (1867), 14 Allen, 381. The same rule prevails under the statutes of Pennsylvania. McCurdy's Appeal (1870), 65 Pa. St. 290.

[2] Hodder *v.* Kentucky & Great Eastern Ry. Co. (1881), 7 Fed. Rep. 793, 797.

[3] Meyer *v.* Johnston (1875), 53 Ala. 237, approved in Savannah & Memphis R. Co. *v.* Lancaster (1878), 62 Ala. 555.

[4] Bank of Little Rock *v.* McCarthy (1892), 55 Ark. 473; s. c. 18 S. W. Rep. 759. See also Davies *v.* Bolton & Co., 3 Ch. 679, disqualified director voting.

The fact that a trust deed differs from that authorized by its board of directors does not destroy its validity where the changes are recognized and approved by the board, and the bonds secured thereby are directed to be sold.[1]

But where the president and secretary of a corporation are directed by a meeting of directors at which a quorum are not present, and of which no notice has been given, to execute a mortgage, and exceed their authority by inserting an unusual provision, the fact that the deed is ratified at a full meeting of the board will not operate as an adoption of that provision where the directors have no knowledge of the actual contents of the mortgage, except as indicated by the order for its execution in the records of the corporation.[2]

(b) *President.* — The president of a railroad company, under a resolution of the directors authorizing him to execute a mortgage on "all the real estate and personal property now or hereafter belonging to the company," may create a specific lien upon the income, profits, and earnings of the road.[3]

And a resolution authorizing the mortgage of "the road and its property, etc.," will authorize a mortgage of the road with all its rights and privileges. The expression "etc.," it was thought, could apply to nothing but the franchises, and should, therefore, be regarded as embracing them.[4]

On the other hand, as a corporate mortgage is usually so drawn as to provide a foreclosure for the whole debt on default of payment of principal or interest, the implied authority of the officer who executed such a mortgage extends to the insertion of a provision to that effect.[5] Compare § 145, *ante.*

If his authority is given in general terms, he may insert in the mortgage any usual provisions, but not unusual ones.[6]

Thus a note of the directors authorizing the president to execute a mortgage to secure the payment of a specific debt does not authorize him to insert in the instrument a contract binding the corporation to pay the mortgagee an attorney's fee in case legal proceedings are taken to enforce the lien.[7]

1 First National Bank *v.* Sioux City Terminal Ry. & Warehouse Co. (1895), 69 Fed. Rep. 441.

2 Pacific Rolling Mill *v.* Dayton, Sheridan, & Grande Ronde Ry. Co. (1881), 5 Fed. Rep. 852.

3 Kelly *v.* Alabama R. Co. (1877), 58 Ala. 489; s. c. 21 Am. Ry. Rep. 138.

4 Bardstown & Louisville R. Co. *v.* Metcalfe (1862), 4 Metc. (Ky.) 199.

5 Savannah & Memphis R. Co. *v.* Lancaster (1878), 62 Ala. 555. See also Farmers' Loan & Trust Co. *v.* Iowa Water Co. (1897), 78 Fed. Rep. 881.

6 Jesup *v.* City Bank of Racine (1861), 14 Wis. 331.

7 Pacific Rolling Mill *v.* Dayton, Sheridan & Grande Ronde R. Co. (1881), 5 Fed. Rep. 852.

If the president, in executing a mortgage, should add something beyond his authority, the excess will not vitiate those provisions of the instrument which can stand without the invalid portion.[1]

And even if his action was not authorized by the original resolution under which he acted, the subsequent approval of the board will be sufficient to give it validity.[2]

No authority to mortgage the property of the company can be inferred, where, under the general incorporation law of a State, the president is merely authorized to preside at the meetings of the directors, and "to perform such other special duties as the directors may authorize," nor is any such power implied from the fact that, under the by-laws of the company, he is appointed its "business and financial agent."[3]

(c) *Superintendent.* — No power to execute a mortgage is vested in an agent appointed by the directors merely for the purpose of superintending and carrying on the business of the corporation.[4]

§ 163. **Requisite Consent of Stockholders.** — The concurrence of the stockholders is not necessary to authorize the execution of a mortgage, where the charter empowers the company to issue and sell bonds, and execute a mortgage to secure the same, and vests the general management and control of the corporate business in the board of directors. The fact that the charter requires such concurrence to authorize consolidation with another company cannot be construed as meaning that a mortgage is invalid without that concurrence.[5]

A new vote of the stockholders to authorize a mortgage is not made necessary by the fact that, since the mortgage was authorized, the interest of the company has changed from an estate for years into a freehold estate.[6]

Where a statute authorizes a company to borrow money and mortgage its property and franchises, upon the concurrence of the holders of two-thirds of the stock, such concurrence to be expressed at a meeting of the stockholders called by the directors, and a mortgage is authorized at a meeting of the directors, who are

[1] Jesup *v.* City Bank of Racine (1861), 14 Wis. 331.

[2] Claflin *v.* South Carolina R. Co. (1880), 8 Fed. Rep. 118, 135. There it was doubtful whether an agreement with a syndicate to furnish money and buy up coupons for interest due, and to secure the retention of the priorities of those coupons, was authorized by the resolution, but the draft of the agreement had been presented to the finance committee of the board and approved.

[3] Luse *v.* Isthmus Transit R. Co. (1876), 6 Or. 125.

[4] Despatch Line of Packets *v.* Bellamy Mfg. Co. (1841), 12 N. H. 205.

[5] Hodder *v.* Kentucky & Great Eastern R. Co. (1881), 7 Fed. Rep. 793.

[6] Evans *v.* Boston Heating Co. (1892), 157 Mass. 37; s. c. 31 N. E. Rep. 698.

shown to be the only stockholders except one, and subsequently assented to by the entire body of shareholders, a substantial compliance with the law is established, and the mortgage will be held valid.[1]

A constitutional provision forbidding an issue of mortgage bonds to secure an increase of indebtedness without the consent of the stockholders, does not apply to a case in which the debts secured have been already incurred;[2] and if, without such consent, bonds are issued partly for the purpose of securing a new indebtedness, the mortgage will be valid to the extent of the prior indebtedness.[3]

Under the New York Manufacturing Act, which provides that a manufacturing corporation may mortgage its goods and chattels, and "also the franchises, rights, privileges, and liberties thereof," provided the written consent of the holders of two-thirds of the stock is obtained, the consent of such stockholders to mortgage the real and personal estate will not authorize a mortgage of the corporate franchises.[4]

The main object of the New York act on this subject being to prevent mortgages by these corporations being given without the assent of owners of more than two-thirds of the stock, in requiring the assent to be in writing, it has been held that a resolution passed at a stockholders' meeting, by the vote of stockholders owning more than two-thirds of the stock, entered upon the minutes, and attested by the secretary, amounted to the "written assent" required.[5]

A corporation which itself owns shares of its own capital stock cannot vote them so as to make up the majority which is a prerequisite under this statute to the validity of a mortgage.[6]

A purchase-money mortgage could be issued without the consent of the stockholders under the former New York statute (Laws of 1848, ch. 37), which authorizes the formation of gas companies.[7]

[1] Thomas *v.* Citizens' Horse Ry. Co. (1882), 104 Ill. 462; s. c. 11 Am. & Eng. R. R. Cas. 306.

For a construction of the special act relating to mortgages by the Northern Pacific Railroad Company, see Da Ponte *v.* Northern Pac. Ry. Co. (1884), 21 Blatch. 534. There the consent of the three-fourths of the preferred stockholders was held to be the necessary condition.

[2] Ahl *v.* Rhoads (1877), 84 Pa. St. 319.

[3] Rothschild *v.* Rochester R. Co. (Pa. Ct. Com. Pl., March, 1887), 1 Ry. & Corp. L. J. 321.

[4] Lord *v.* Yonkers Fuel & Gas Co. (1885), 99 N. Y. 547; s. c. 2 N. E. Rep. 909.

[5] Beebe *v.* Richmond Light, Heat, & Power Co. (1895), 13 Misc. Rep. 737; s. c. 35 N. Y. Suppl. 1.

[6] Vail *v.* Hamilton (1881), 85 N. Y. 453.

[7] Farmers' Loan & Trust Co. *v.* Equity Gas Light Co. (1894), 84 Hun, 373.

An objection that a mortgage of a business corporation under the laws of New York was not authorized by the assent of stockholders owning two-thirds of the stock, may be taken by any one interested in defeating the mortgage.[1]

§ 164. **Notice of Meeting.** — The requirement of the Mass. Pub. Stat., ch. 106, § 23, that a mortgage of corporate property must be authorized "at a meeting called for that purpose," is satisfied when the notice of the meeting states the object to be "to consider the question of an issue of bonds of the company secured by a mortgage of its property.[2]

§ 165. **Place of Execution, Acknowledgment, or Authorization.** — In an early case in Indiana the validity of a railroad mortgage was attacked on the ground that it had been executed out of the State. This objection was disposed of by the court in the following manner: —

"We do not think the contract void because executed out of the State. There is nothing in our railroad act requiring the directors of corporations to transact their business within the State. It is true that corporations cannot migrate from one sovereignty into another so as to become legal, local existences within the latter sovereignty; but it is also true that the migration of the directors of a corporation from one sovereignty into another does not terminate the existence of such corporation within the sovereignty which created it; for by our statute (1 Rev. Stats., p. 409) the stockholders are the corporation, the directors its agents, and by inter-State and international courtesy corporations created in one State are permitted to contract and sue in others; and if all the directors could there, as agents of the corporation, make a contract, why can they not there authorize one of their number to make it?

"The mere place where the active agents of a corporation enter into a contract must, in general, be immaterial. The important question arising must be one of power, not of place. The exercise of the power has relation to the place of their legal establishment, where the contract may be subsequently acted under. The meetings of the directors of a business corporation are not analo-

[1] Beebe *v.* Richmond Light, Heat, & Power Co. (1895), 13 Misc. Rep. 737; s. c. 35 N. Y. Suppl. 1. This was settled in the case of Lord *v.* Yonkers Fuel & Gas Co. (1885), 99 N. Y. 547; s. c. 2 N. E. Rep. 909.

Doubts as to this point had been expressed by the courts previously to this decision, in Greenpoint Company *v.* Whitin (1877), 69 N. Y 328; Paulding *v.* Chrome Steel Co. (1884), 94 N. Y. 334; Rochester Bank *v.* Averell (1884), 96 N. Y. 473.

[2] Evans *v.* Boston Heating Co. (1892), 157 Mass. 37; s. c. 31 N. E. Rep. 698.

gous to the sessions of a judicial tribunal. The corporation is organized by the election of directors; but the mere organization of the directors into a formal meeting for business afterwards is quite a different thing.

"States cannot migrate, but by their agents they are daily making contracts without their territorial boundaries. Besides, our law seems to contemplate that corporations chartered in this State, and local to it, may have offices for business in other States. 1 Rev. Stats., p. 113, § 32; Acts of 1853, p. 102. Such, also, is the spirit of our legislation authorizing railroad companies in this State to consolidate with those in other States." [1]

In a Vermont case a like conclusion has been reached; but the argument against the validity was based not so much on the want of statutory authority as on the theory that the resolution of the directors empowering the president to execute and deliver the mortgage in the name of the corporation did not empower him to exercise the agency so conferred outside the State. The court held that, as he had not been directed to execute the mortgage in any particular place, a restriction in this respect could not be implied, especially as the validity of the deed had been subsequently authorized by the company.[2]

A similar ruling has been made in a case where the president of a company operating a railroad in Kentucky acknowledged the execution of a mortgage on its property while he was residing in Ohio.[3]

On grounds similar to those which control the cases just noticed, it is held that a company cannot repudiate a mortgage given to secure its bonds, at least after they have passed into the hands of *bona fide* holders, for the reason that the resolution by which the execution of the instrument was authorized was passed outside the State.[4]

[1] Wright *v.* Bundy (1858), 11 Ind. 398, 404.

For a case involving a mortgage of a corporation where the meeting of directors was called to be held at a place other than the principal place of business of the corporation, see Corbett *v.* Woodward (1879), 5 Sawy. 403; s. c. 6 Fed. Cas. 531, Case No. 3223.

[2] Cheever *v.* Rutland R. Co. (Vt., Nov., 1869), 4 Am. Ry. Rep. 291. It was also held that such a mortgage could not be invalidated on the grounds that it allowed the trustees to be residents of another State. Such a provision is not contrary to public policy.

[3] Hodder *v.* Kentucky & Great Eastern R. Co. (1881), 7 Fed. Rep. 793, affirmed in Wright *v.* Kentucky & Great Eastern R. Co., 117 U. S. 72. In Kelly *v.* Calhoun, 95 U. S. 710, the circumstances were such as to involve the same point, but it was not raised, the case being made to turn on the sufficiency of the certificate of acknowledgment, couched in terms somewhat different from that employed in the formula prescribed by the statute of the State in which the corporation was organized.

[4] Galveston Railroad *v.* Cowdrey (1876), 11 Wall. 459. The estoppel in such a case extends to the purchaser at an execution sale of the road.

This doctrine is placed in Vermont on the grounds that the directors in conferring authority to execute a deed are not performing an act, but are themselves acting as agents of and in behalf of the corporation.[1]

This power of acting through agents beyond the limits of the State is not affected by a constitutional requirement that every railroad corporation organized or doing business in a State under its laws shall have a public office or place of business in that State. Such a provision is not intended to prevent the corporation from having an office beyond the limits of the State also, nor to invalidate the acts which it performs outside the State.[2]

A resolution authorizing the execution of a mortgage on the property of a company which owns a line extending through several States, from each of which it has received a charter, making it a corporation in and of that State, may be lawfully passed at a meeting held in any one of those States.[3]

§ 166. **Bondholders entitled to presume that the Mortgage has been regularly executed.** — It has been stated above (in Chap. II.) that a bondholder purchasing bonds which on their face have been issued in accordance with the provisions of the statute or other instrument from which the corporation derives the authority for such issue, and purport to have been executed by the proper formalities, is not bound to inquire into the manner in which they may have been actually executed by the corporate officers (§ 37). A similar rule prevails as respects the right of the bondholders to assume the mortgage to be valid.

Thus the fact that the seal was affixed by resolution at a meeting of directors at which less than a quorum was present will not invalidate the mortgage, as between the corporation and a mortgagee without notice of the irregularity.[4]

[1] Arms *v.* Conant (1864), 36 Vt. 744.

[2] Hervey *v.* Ill. Midl. R. Co. (1884), 28 Fed. Rep. 169, 175. In this case the court was also referred to a statutory provision which avoided the acts of any meeting beyond the limits of the State, unless that meeting was authorized or its acts ratified by a vote of two-thirds of the directors or trustees, but was of the opinion that, even if that provision applied to any railroad corporations except those operating *horse and dummy roads*, the evidence showed that the meeting at which the mortgage was authorized had been duly convened, or at least subsequently ratified and approved.

[3] Graham *v.* Boston, Hartford, & Erie R. Co. (1883), 14 Fed. Rep. 753; s. c. 118 U. S. 161 (1886). In this case it was determined, upon an examination of the several statutes under which the consolidated company was doing business, that, while it was originally a Connecticut corporation, it had acquired a domicil also in Massachusetts, Rhode Island, and New York, and apart from this fact it also appeared that the proceedings of the company in making the mortgage had been expressly ratified by the legislature of all the States.

[4] County of Gloucester Bank *v.* Rudry Merthyr, etc. Co. (1895), L. R. 1 Ch. 629. See § 162, *ante*.

Nor is the validity of a corporate mortgage executed by two out of three directors affected, as regards the mortgagee, by the fact that no notice of the meeting of directors was given to the third director, unless the mortgagee has actual knowledge of the absence of such notice. Whether such notice was given or not is a matter into which the mortgagee is not bound to examine.[1]

For additional cases illustrating this rule see Art. IV., *post.*

§ 167. **Mortgages validated by Ratification.**[2] — The general rule as to ratification and its *rationale* is thus clearly stated in a recent New York case: "The stockholders are the equitable owners of the corporate property, and if the officers or trustees do an unauthorized act, or incur indebtedness which would not create a corporate liability, the stockholders may subsequently ratify the acts and validate the originally unauthorized transaction. What they might originally have done they may do afterward, and their subsequent assent is equivalent to original authority.[3]

Although a trust deed authorized by the board of directors may differ in the manner of its execution in many particulars from the one authorized, if it appears that the directors afterwards recognized its validity, and directed the sale of the bonds secured by it, it will not be held to be void.[4]

A corporation which has executed a corporate mortgage upon its property to secure its bonds, and afterwards sells its property to another corporation subject to the lien of this mortgage, and not contracting with its vendee for the payment of the mortgage debt, nor giving a guaranty that there will be no foreclosure of the mortgage, will not be heard in a court of equity to claim the mortgage invalid because of its lack of authority to execute it.[5]

[1] Kuser *v.* Wright (1894), 52 N. J. Eq. 825; s. c. 31 Atl. Rep. 397.

[2] Some cases dealing with the operation of the analogous principle of estoppel will be found in § 173, *post.* See also § 162, *ante.*

[3] Martin *v.* Niagara Falls Paper Manufg. Co. (1890), 122 N. Y. 165; s. c. 25 N. E. Rep. 303; 9 Ry. & Corp. L. J. 15.

[4] First Nat. Bank of Montpelier *v.* Sioux City Terminal R. & Warehouse Co. (Trust Co. of North America, Intervener) (1895), 69 Fed. Rep. 441.

As to what would amount to an authorization of the directors of a corporation to execute a corporate mortgage, or a ratification of its execution, see Boggs *et al. v.* Lakeport Agricultural Park Assn. *et al.* (Cal., 1896), 43 Pac. Rep. 1106; Ashley Wire Co. *et al. v.* Illinois Steel Company, 60 Ill. App. 179 (1895).

For a rule as to the authorization and execution of mortgages by a corporation, see Atlantic Trust Co. *v.* The Vigilanion *et al.* (1896), 73 Fed. Rep. 452; s. c. 19 C. C. A. 528.

As to the ratification of an unauthorized mortgage by a corporation, see Blood *v.* La Serena Land & Water Co. (Cal., 1895), 41 Pac. Rep. 1017.

[5] American Waterworks Co. of Illinois *et al. v.* Farmers' Loan & Trust Co. (1896), 73 Fed. Rep. 956.

Any technical defect in the original execution of a corporate mortgage is cured by the corporation's subsequent acquiescence, — as where it uses the consideration received by the officers upon the execution of the mortgage.[1]

Ratification, however, can never be given effect, so as to displace intervening rights that have accrued while the mortgage was still awaiting validation in this manner. Thus the lien of a mortgage, invalid because not authorized by the directors and not sealed, will be postponed to the claims of parties whose claims have become fixed at any time prior to ratification.[2]

A resolution of a corporation authorizing the president and secretary to execute mortgages subject to mortgages previously executed by them, and specified therein, is a ratification of the notes secured by the mortgage, as well as of the mortgages themselves, although the notes are not expressly mentioned.[3]

But where the votes of a certain proportion of the stockholders are required to enable the directors to mortgage the corporate property, there is no legal ratification of an unauthorized mortgage unless it is formally adopted by at least that number of stockholders. The fact that an assessment to pay the mortgage is levied by the vote of a mere majority of the stockholders, and actually paid by two-thirds of them, does not constitute a valid ratification.[4]

§ 168. **Improper Application of the Proceeds of the Bonds, Trust Deed not invalidated by.** — It has been stated above (in Chap. II.) that the misapplication of the proceeds of the bonds will not invalidate those instruments in the hands of the holders. For analogous reasons such misuse of the loan will not affect the rights of the beneficiaries of the mortgage securing the bonds.[5]

§ 169. **Fraud inferred from Personal Interest of Officers in Contract.** — Where the president and vice-president of a railroad company are secret members of a company organized with a declared object of completing and acquiring the ownership of the railroad, a mortgage made by the railroad company to secure a debt due to the construction company will, in view of the fiduciary relations between the parties, be pronounced constructively

[1] Dexter, Horton, & Co. *v.* Long (1891), 2 Wash. 435; s. c. 27 Pac. Rep. 271.

[2] National Foundry & Pipe Works *v.* Oconto Water Co. (1895), 68 Fed. Rep. 1006.

[3] Shaver *v.* Hardin (1891), 82 Iowa, 378; s. c. 48 N. W. Rep. 68.

[4] Forbes *v.* San Rafael Turnpike Co. (1875), 50 Cal. 340. See § 163, *ante*.

[5] Robinson *et ux.* *v.* Dolores Number Two Land & Canal Co. *et al.* (1892), 2 Colo. App. 17; s. c. 29 Pac. Rep. 750.

fraudulent; but in bankruptcy proceedings the advance may be proved as an unsecured debt.[1]

So also though the bonds evidencing the sums of money due on a construction contract are held void, for the reason that the directors of the railroad company are interested in the construction company, the mortgage securing the bonds may be foreclosed in order that the sums of money actually expended on the construction of the road may be paid to the bondholders.[2]

There are, however, some transactions between the company and the directors which are not constructively fraudulent, but are allowed to stand, on the ground that they are for the interest of the company, and the directors have not thereby obtained any unfair advantage. Thus the action of a board of directors of a corporation in delivering corporate stock in payment of a portion of its indebtedness, and consolidating the remainder into a mortgage on the corporate property, is not rendered illegal by the fact that members of the board have become guarantors for further advances made to the corporation, after it had exhausted its credit, which advances were to be paid by the delivery of the stock; nor will an issue of bonds in pursuance of such an agreement be enjoined.[3]

Nor can subsequent creditors attack the validity of bonds issued for the purpose of reimbursing a director who has made large advances out of his own means, and of raising money to enable him to complete the work of construction which he has undertaken, unless some actual bad faith, irregularity, or fraud in the execution of the mortgage is shown.[4]

§ 170. **Constructive Fraud as to Creditors and Preferences.** — Circumstances which, in the case of an ordinary grantor, would render a mortgage fraudulent as to creditors will not necessarily have that effect in the case of a railroad company. Thus a mortgage executed by an insolvent railroad company to secure bonds issued for the purpose of enabling it to complete its road is not void for the reason that the company is insolvent, nor yet because it is provided in the deed that the whole estate which it covers is to be retained by the company until the maturity of the bonds, and then sold, in case of default, for the benefit of the holders of the bonds primarily, and afterwards of its general creditors.[5]

[1] Kappner *v.* St. Louis & St. Joseph R. Co. (1875), 3 Dill. 228.

[2] Thomas *v.* Brownville, Fort Kearney, & Pac. R. Co. (1883), 109 U. S. 522; s. c. 3 Sup. Ct. Rep. 315.

[3] County Court of Taylor County *v.* Baltimore & Ohio R. Co. (1885), 35 Fed. Rep. 161.

[4] Porter *v.* Pittsburgh Bessemer Steel Co. (1886), 120 U. S. 649.

[5] Allen *v.* Montgomery & West Point R. Co. (1847), 11 Ala. 437. Such a

A similar ruling has been made as to the effect of a provision allowing the company before default to sell, hypothecate, or otherwise dispose of any of its property not necessary, in its judgment, for the use of the road. The very nature of the business of a railroad company, the means and power requisite to keep it up, the wear and tear of its rails, ties, and rolling-stock, and the constant necessity of replacing injured or worn-out appurtenances with new ones, were declared to negative the existence of any fraudulent purpose in inserting such a provision.[1]

So also, in the absence of a statute forbidding preferences, a mortgage executed to secure bonds the proceeds of which are to be used to pay debts and current expenses is not invalid as against judgment creditors, even if the company be insolvent,[2] provided, of course, the transaction is a *bona fide* one, and there is no purpose at the time of immediately abandoning business or making an assignment.[3]

As has been said in a Pennsylvania case, "The purpose of a railroad, the nature of its property, the necessity of possession to accomplish its purpose, and the powers conferred in [its] charter [to 'pledge its property and income'], leave no room to doubt the validity of a mortgage, without delivery of possession, of those chattels which are necessary to carry out the object of incorporation." [4]

Hence, although the income received by a company between the time when a mortgage covering it was executed, and the time when the mortgagee forecloses the mortgage, or enters into possession of the road, is left in the possession of the mortgagor with powers of use and disbursements, as the income is of the nature of personal property, this fact does not raise any implication of fraud whereby the mortgage is rendered void as to creditors.[5]

But although the insolvency of a corporation does not deprive it of the power of preferring one creditor or class of creditors, provided it is still a going concern when the preference is granted, this power cannot be exercised in favor of the directors, and a

stipulation, it was said, had no tendency to hinder or delay creditors, as they could, at any time after their judgments, have compelled the trustees to close the trust.

[1] Butler *v.* Rahm (1877), 46 Md. 541; 18 Am. Ry. Rep. 86.

[2] Bergen *v.* Porpoise Fishing Co. (1886), 42 N. J. Eq. 397; s. c. 8 Atl. Rep. 523.

[3] Damarin & Co. *v.* Huron Iron Co. (1891), 47 Ohio St. 581; s. c. 26 N. E. Rep. 37; 32 Am. & Eng. Corp. Cases, 625.

[4] Covey, for the use, etc. *v.* Pittsburg, Fort Wayne, & Chicago R. Co. (1858), 3 Phil. 173, 178, per Agnew, P. J.

[5] Jessup *et al.* Trustees, *v.* Bridge *et al.* (1861), 11 Iowa, 572.

mortgage given for that purpose is invalid as against a general creditor.[1]

§ 171. **Effect of the Chattel-mortgage Acts.** — The principles illustrated in the foregoing section are, however, considerably modified, in regard to the personal property of the company, by the statutes of some States which make a mortgage of such property void as to purchasers, mortgagees, and creditors, unless the mortgage is recorded or the property is delivered to the mortgagee. These statutes have usually been discussed in connection with the question whether the rolling-stock is a fixture, and the cases on the subject have been placed in that portion of this treatise which deals with that question. In Montana a special statute has been passed for the recording of railroad mortgages rendering registration in each county unnecessary, and this law was not repealed by the more recent Chattel Mortgage Acts.[2]

Railway mortgages are not within the purview of State statutes regulating chattel mortgages.[3]

A chattel mortgage, even if not properly registered, is good against every one who is not hindered or defeated, and will ordinarily prevail against the mortgagor himself, and also against a subsequent purchaser or mortgagee of the chattels with notice.[4] But the terms of the statute may be such as to place the creditors in a more favored position in this respect, and if it is provided in unqualified terms that the mortgage shall be void against creditors unless it is duly registered, or accompanied by an immediate delivery of things mortgaged, followed by an actual and continued change of possession, the fact that the creditor has notice of the mortgage will not prevent him from taking advantage of the failure to comply with the requirements of the statute.[5]

[1] Howe, Brown, & Co. *v.* Sanford Fork & Tool Co., 44 Fed. Rep. 231 (1890); s. c. 9 Ry. & Corp. L. J. 185.

[2] Gilchrist *v.* Helena, H. S. & S. R. Co. (1891), 47 Fed. Rep. 593. See Manhattan Trust Co. of New York *v.* Seattle Coal & Iron Co. (1897), Wash. 48 Pac. Rep. 333, for a ruling as to the Chattel Mortgage Act of Washington.

[3] Farmers' Loan & Trust Co. *v.* Detroit, B. C. & A. R. Co., *In re* Keating (1895), 71 Fed. Rep. 29.

In Hammock *v.* Loan & Trust Co. (1881), 105 U. S. 77; s. c. 7 Am. & Eng. R. R. Cas. 465, the Supreme Court of the United States held that the Illinois statute as to chattel mortgages was couched in such terms that the legislature could not have intended that it should be applicable to the personalty of railroad companies.

[4] Williamson *v.* N. J. Southern R. Co. (1875), 26 N. J. Eq. 398.

[5] Williamson *v.* N. J. So. R. Co., 29 N. J. Eq. 311, citing Farmers' Loan & Trust Co. *v.* Hendrickson (1857), 25 Barb. 485; Stevens *v.* Buffalo & N. Y. City R. Co. (1858), 31 Barb. 590; Thompson *v.* Van Vechten (1863), 27 N. Y. 568.

On the other hand, if the mortgage merely declares that the mortgage is void, except as between the parties, "unless possession of such property is delivered to and retained by the mortgagee, or the mortgage is recorded," an unrecorded mortgage will take precedence of an attachment lien, provided possession is actually taken before the levy is made.[1]

There is a sufficient change of possession within the meaning of such statutes where the trustees assume control of the road, even though they carry on the business through the agency of the former superintendent and other employees of the company.[2]

Where it is necessary to the validity of a mortgage covering rolling-stock that the instrument should be registered as a chattel mortgage, or that possession should be taken by the mortgagee, the lien cannot prevail against creditors whose claims accrued before the mortgagee was entitled under the terms of his mortgage to take possession.[3]

The term "apparatus," in a mortgage of the real estate and property of an electric lighting company, will include the lamps. It is therefore good to that extent as a chattel mortgage, and must be filed as such to prevail against subsequent creditors.[4]

The capital stock of a corporation is not goods and chattels within the meaning of the Chattel Mortgage Acts, and the mortgage of such stock need not be filed according to the provisions of those acts.[5]

A mortgage of railroad personalty shown to be valid by the *lex loci contractus* will be treated as valid in another State, on the principle of comity, although it does not comply with the law of that State under which the registration, in accordance with the provisions either of the Chattel Mortgage Acts or the statute relating especially to the mortgage of railroad personalty, is an indispensable condition of validity.[6]

§ 172. **Mortgage to secure Future Advances when not invalid.** — A mortgage of railroad property to secure bonds to be issued

[1] Hamlin *v.* Jerrard (1881), 72 Me. 62; 9 Am. & Eng. R. R. Cas. 488. In this case the trustee in possession recovered in trespass against a sheriff who levied on certain rolling-stock covered by the mortgage.

[2] Palmer *v.* Forbes (1860), 23 Ill. 301.

[3] Radebaugh *v.* Tacoma & P. R. Co. (1893), 8 Wash. 570; s. c. 36 Pac. Rep. 460.

[4] Ramsdell *v.* Citizens' Electric Light & Power Co. (1894), 103 Mich. 89; s. c. 61 N. W. Rep. 275.

[5] Williamson *v.* New Jersey Southern R. Co. (1875), 26 N. J. Eq. 398.

[6] Mase *v.* Nichols (1863), 94 N. Y. 160; s. c. 17 Am. & Eng. R. R. Cas. 230.

to raise money to pay the debts of the corporation cannot be declared invalid merely on the ground that it is given to secure future advances.[1]

But if the rights of a creditor to seize the estate of the corporation becomes complete by judgment and execution before the bonds come into possession of a *bona fide* holder, the mortgage will not operate against that right.[2]

ARTICLE III. — PARTIAL INVALIDITY OF CONTRACT, EFFECT OF.

§ 173. **Invalidity of Part of Bonds, Validity of Mortgage not affected by.** — The fact that some of the bonds secured by a mortgage are invalid will not, as a general rule, affect the validity of the mortgage, or the proceedings for its foreclosure.[3]

§ 174. **Mortgage may be Valid as to a Part of the Road and Void as to the Residue.** — Thus where two companies organized in different States become consolidated into a single company, which takes the name of one of the constituent companies, and a mortgage is executed by the consolidated company covering the entire property, then, even if the consolidation contract is illegal, the mortgage will be good as to that part of the line which is rightfully owned by the constituent company whose name was adopted by the consolidated company. The principle governing such a case is that the consolidation does not make the constituent companies one corporation of both States, or of either. The corporation of each State continues a corporation of the State of

[1] Richards *v.* Merrimack & Connecticut River Railroad (1862), 44 N. H. 127; Mobile & Cedar Point R. Co. *v.* Talman (1849), 15 Ala. 472 (a case of an equitable mortgage); Allen *v.* Montgomery & West Point R. Co. (1847), 11 Ala. 437.

[2] Allen *v.* Montgomery & West Point R. Co. (1847), 11 Ala. 437. The court added: "In our judgment the validity of a conveyance of this description rests on precisely the same principles as obtained when deeds are made which provide for the security of future advances or future liabilities." The doctrine stated in the text would perhaps not be approved in some States without qualification. For discussions of the protection afforded to a mortgagee by a mortgage for future advances, see articles in 11 Weekly Law Bulletin, 157; II Am. L. Rep. (N. S.) 273; 2 Am. L. Reg. (N. S.) 1; 3 Am. L. Reg. (N. S.) 79–93; Pingrey on Mortgages, §§ 483 *et seq.* In Neilson *v.* Iowa Eastern R. Co. (Iowa, 1875), 8 Am. Ry. Rep. 82, it was held that a mortgagee who has contracted to make advances or incur liabilities may tack the liabilities incurred on the advances made by him to the mortgage, and his mortgage, when recorded, is a valid lien upon the property for all such claims, even though the liabilities were incurred on the advances made after he had notice of subsequent mortgages or incumbrances on the property.

[3] Graham *v.* Boston, Hartford, & Erie R. Co., 118 U. S. 161; Pullan *v.* Cincinnati & Chicago Air Line R. Co. (1865), 4 Biss. 35; Rothschild *v.* Rochester R. Co. (Penn. Ct. of Com. Pleas, 1887), 1 Ry. & C. L. J. 321.

its creation, although the same persons, as officers and directors, manage and control both corporations as one body.[1]

§ 175. **Mortgage of the Franchises may be Valid as to Part of them and Invalid as to the Rest.** — Thus where a mortgage is executed in accordance with the provisions of an enabling statute, covering the whole of the property of the franchises of a railroad company, and another statute is subsequently passed permitting the alteration of a portion of the route, the altered section of the road may perhaps be regarded as having been built under the franchise granted by the latter act, and not by way of substitution. But even if that view be taken, the operation of the mortgage upon so much of the road as was constructed within the limits of the franchise originally granted will not be invalidated for the reason that the altered section is embraced in the deed.[2]

§ 176. **Excess of Powers by Officer as regards a Part of the Mortgage.** — The fact that the officer deputed to execute the mortgage transcends his powers by inserting a stipulation that the principal sum is to become due at the option of the holder, on default of the payment of the interest, will not vitiate the mortgage as a whole.[3]

§ 177. **Defective Execution as to One Kind of Property, Effect of.** — Where a mortgage is defectively executed as regards realty, but fulfils the legal requirements as to a mortgage of personalty, the latter part will be sustained.[4]

ARTICLE IV. — WHO MAY AND WHO MAY NOT QUESTION THE VALIDITY OF THE MORTGAGE.

§ 178. **The Mortgagor Company.** — The right of the corporation or of the stockholders to assail the validity of a mortgage executed by the corporate officers without the due observance of the formalities and procedure prescribed by the charter or the by-laws is a necessary corollary of the elementary rule that a principal may always repudiate the unauthorized act of an agent. Moreover, it is only by the corporation or the stockholders that this defect of authority can be taken advantage of. It is well settled, therefore, that a mortgage which was within the powers of the

[1] Racine & Mississippi R. Co. *v.* Farmers' Loan & Trust Co. (1868), 49 Ill. 331.

[2] East Boston Freight R. Co. *v.* Eastern R. Co. (1866), 13 Allen, 422; Butler *v.* Rahm (1877), 46 Md. 541; Gloninger *v.* Pittsburg & Connellsville R. Co. (1890), 139 Pa. St. 13; s. c. 21 Atl. Rep. 211; 27 W. N. C. 497.

[3] Jesup *v.* City Bank of Racine (1861), 14 Wis. 331.

[4] Despatch Line of Packets *v.* Bellamy Mfg. Co. (1841), 12 N. H. 205.

corporation, but was not executed with the formalities prescribed either by statute or the corporate by-laws, as a safeguard against improvident contracts, can be avoided only by the corporation or the stockholders for whose benefit those formalities were intended.[1]

The right of the corporation and its members is of course subject to the same limitations as those which restrict the right of any other principal from releasing himself from an obligation which an ageut has contracted in his behalf; that is to say, the corporators will not be permitted to repudiate a mortgage, if their subsequent conduct can be construed as an intentional ratification thereof. For a review of some cases in which this rule has been applied, see § 163, *ante*. Similarly the principle of equitable estoppel will sometimes operate to prevent the corporation from relieving itself of the obligation of the mortgage. Perhaps the most frequent illustration of this result is found in those cases where the corporation has acted under its contract and received the benefit arising from it. Under such circumstances it will not be allowed, after receiving the loan secured by a mortgage, to avoid its liability, by raising the question of its power to make the mortgage, or showing that such power has been defectively executed,[2] nor by denying the authority of the agents who contracted the loan on its behalf.[3]

On similar grounds a company which executes a mortgage to indemnify another which has guarantied the bonds of the mortgagor, cannot, after the liabilities thus assumed have been met as a real one, and discharged as to certain coupons which the mortgagor has failed to pay, invalidate the mortgage on the ground that the giving of the guaranty was illegal.[4]

Thus when the stockholders sanction a contract under which moneys were loaned to a corporation by its directors, and its

[1] Campbell *v.* Argenta Gold & Silver Min. Co. (1892), 51 Fed. Rep. 1; Hervey *v.* Ill. Midland R. Co. (1884), 28 Fed. Rep. 169; Beecher *v.* Marquette & Pac. Rolling Mill Co. (1881), 45 Mich. 103. Consult also the two following sections.

[2] Dimpfel *v.* Ohio & Miss. Ry. Co. (1879), 9 Biss. 127; Tex. West. R. Co. *v.* Gentry (1888), 69 Tex. 625; s. c. 33 Am. & Eng. R. R. Cas. 46; Hervey *v.* Ill. Midland R. Co. (1884), 28 Fed. Rep. 169; Thomas *v.* Citizens', etc. R. Co. (1882), 104 Ill. 462; s. c. 33 Am. & Eng. R. R. Cas. 306; Peoria, etc. R. Co. *v.* Thompson (1881), 103 Ill. 187.

[3] Miller *v.* Rutland & Washington R. Co. (1863), 36 Vt. 452, citing Redf. Rail. 572; Curtis *v.* Leavitt (1857), 15 N. Y. 947; Elwell *v.* Grand Street & Newtown R. Co. (1874), 67 Barb. 83; Mobile & Cedar Point R. Co. *v.* Talman (1849), 15 Ala. 472; Frank *v.* Hicks (Wyo., 1894), 35 Pac. 475; Witter *v.* Grand Rapids Flouring Mill Co. (1891), 78 Wis. 543; s. c. 9 Ry. & Corp. L. J. 236; 47 N. W. Rep. 729.

[4] Macon & Augusta R. Co. *v.* Georgia R. & Bkg. Co. (1879), 63 Ga. 103; s. c. 1 Am. & Eng. R. R. Cas. 378.

bonds therefor secured by mortgage given, and the moneys have been properly applied, the corporation is estopped from setting up that the bonds and mortgage are void by reason of the trust relation which the directors sustain to it.[1]

The rule that neither party to a fraudulent contract has a standing in a court of equity to have it set aside is as applicable to corporations as to individuals, and operates so as to prevent a mortgagor railroad company from procuring the cancellation of a mortgage executed as a part of a scheme by which the directors acting within the scope of their powers attempt to obtain, through a construction contract with a company of which they are members, certain unfair advantages for themselves. Such a contract cannot be enforced; but, on the other hand, neither party can ask to have it set aside.[2]

The agent's want of authority must be promptly taken advantage of as soon as it is ascertained. Otherwise his act will be treated as having been validated by the subsequent acquiescence of the corporation.[3]

Where a railroad mortgage which has been authorized by resolution of a board of directors of the company, and executed by its officers, and, upon discovery of an omission of a default clause in the same, altered by action of its officers, to meet the requests of proposed purchasers of bonds, by inserting such clause without a re-execution of the mortgage, the mortgagor company, as against the purchasers of bonds, upon a representation that it was all right, will not be allowed to claim the mortgage to be invalid by reason of the alteration.[4]

§ 179. **The Stockholders individually.** — Stockholders, if they stand by without objection and allow the bonds secured by a mortgage to pass into the hands of *bona fide* purchasers, and large sums to be invested on the faith of validity of the security, will be estopped from denying that validity afterwards; and the longer the time during which they have omitted to assert their rights, the stronger are the reasons for refusing to allow them to impair that validity.[5]

[1] Hotel Co. *v.* Wade (1877), 97 U. S. 13.

[2] Lewis *v.* Meier (1882), 14 Fed. Rep. 311.

[3] Augusta, Tallahassee, & Gulf R. Co. *v.* Kittel (1892), 52 Fed. Rep. 63; s. c. 2 C. C. A. 615.

[4] Woodbury *et al.* *v.* Allegheny & K. R. Co. *et al.* (1895), 72 Fed. Rep. 371.

[5] Boston & Providence R. Co. New York & New England R. Co. (1881), 13 R. I. 260; s. c. 2 Am. & Eng. R. R. Cas. 300. In this case the complainants were minority stockholders, without whose assent the company had leased the road in perpetuity to another company, the effect of the agreement being to leave nothing to the lessor but the bare franchise to exist

After the bonds have been issued to *bona fide* purchasers, it is too late to question the authority of the directors to insert a power of sale in the trust deed securing them.[1]

§ 180. **Junior Mortgagees.** — If two mortgages are made, both purporting to convey the same property, the question whether the company had the power to convey that property cannot be raised by the junior mortgagee, for the only claim which that mortgagee has upon the property of the company necessarily depends upon the existence of the very power which, by attacking the validity of the first mortgage, he denies the company to possess.[2]

This rule is, of course, subject to the qualification that, if the junior mortgage is executed by virtue of express statutory authority, and not of the law upon the construction of which the validity of the prior mortgage depends, the junior mortgagee is in a position to take advantage of any defect in the prior mortgage.[3]

Nor can a junior mortgagee object to the validity of a prior mortgage executed without the requisite consent of the stockholders where the latter have acquiesced in the contract.[4]

Still less can a junior mortgagee impeach the indebtedness

as a corporation. This being a transaction which the majority had no right to carry out against the will of the minority, it was held that the latter might have set it aside by a timely application. As they had not made such an application, and permitted a mortgage by the lessee company to stand unquestioned for twelve years, they were denied relief.

In Central Trust Co. *v.* Marietta & North Ga. R. Co. (1891), 48 Fed. Rep. 14, a trustee brought suit to foreclose a mortgage executed by a consolidated railroad company which was formed by the union of a Georgia corporation with a North Carolina corporation and a Tennessee corporation. Certain stockholders in the original Georgia corporation filed a petition asking to be allowed to defend against the suit, on the ground that the mortgage was invalid and void, for the same reason that the consolidation of the companies was illegal, and that there was no authority to execute the mortgage. As an additional reason for granting the application the company was alleged to be so situated as to be estopped to make this defence, even if disposed to do so. The court refused the prayers of the petition for the reason that there was no charge of fraud or collusion on the part of the company and its officers, and the stockholders were left to assert their rights by an independent proceeding. For a statement of the circumstances under which the court thought it *very questionable* whether not only the company itself, but the administrator of a deceased president of the company and holder of its stock, should not be estopped to deny the validity of a mortgage, see McIlhenny *v.* Binz (1890), 80 Tex. 1; s. c. 13 S. W. Rep. 655.

[1] State *v.* Brown (1855), 64 Md. 199.

[2] McAllister *v.* Plant (1876), 54 Miss. 106.

[3] Commonwealth *v.* Smith (1865), 10 Allen, 448. Here the junior mortgagee was the State itself.

It was held that such a case does not fall within the principle that a violation of corporate powers cannot be taken advantage of collaterally. The court, however, dismissed the bill for the cancellation of the first mortgage, on the ground that the petitioner had an adequate remedy at law.

[4] Campbell *v.* Argenta Gold & Silver Mining Co. (1892), 51 Fed. Rep. 1. See § 163.

secured by an earlier mortgage of which he has notice, where all the defects of consideration, and all equities existing to the prejudice of the prior bonds, have been waived and extinguished by the obligor.[1]

A chattel mortgagee having knowledge of prior mortgages is not a *bona fide* mortgagee, and cannot impugn them on the ground that they were not properly filed.[2]

Parties standing in the same position as junior mortgagees are subject to the same disabilities, so far as regards impugning the validity of an earlier contract. Thus bondholders secured by a mortgage which expressly recognizes the superiority of the obligation created by a lease which, in legal effect, amounts to a pledge of the tolls and income, cannot question the legal capacity of the company to execute the lease.[3]

Since the directors of an insolvent corporation become trustees for its creditors, a bill to set aside as fraudulent a deed of trust of corporate assets to secure debts for which the directors are themselves liable as sureties need not show that the complainant has established his claim by judgment.[4]

§ 181. **General Creditors of the Company.** — These cannot question the validity of a mortgage, so far as regards its execution and delivery, where such execution and delivery are admitted by the company.[5]

Nor can they be heard to impugn the validity of a mortgage executed by the same board of directors as that with which he contracted, on the ground that such board was not legally constituted, for his own claim must necessarily be invalid if the directors were illegally acting as such.[6] (Compare the similar rule as to junior mortgagees, § 180, *ante.*)

Nor can they raise the objection that the resolution pursuant to which the mortgage was executed was not passed at a general meeting, as required by the by-laws.[7]

[1] Coe *v.* East & West R. Co. of Alabama (1894), 52 Fed. Rep. 531, citing Bronson *v.* La Crosse & Milwaukee R. Co., 2 Wall. 283, 287; Graham *v.* Railroad Co. (1880), 102 U. S. 148.

[2] Benjamin *v.* Elmira, Jefferson, & Canandaigua R. Co. (1873), 54 N. Y. 675.

[3] Vermont & Canada R. Co. *v.* Vermont Central R. Co. (1861), 34 Vt. 1.

[4] Consolidated Tank Line Co. *v.* Kansas City Varnish Co. (1891), 45 Fed. Rep. 7; s. c. 9 Ry. & Corp. L. J. 329.

[5] Hervey *v.* Illinois Midland R. Co. (1884), 28 Fed. Rep. 169, 174. The mortgage in this case was assailed on the ground of failure to comply with the provisions of an act requiring the assent of a certain number of shareholders to the execution of a mortgage. This statute was said to be primarily, if not exclusively, for the benefit of the stockholders.

[6] Porter *v.* Pittsburgh Bessemer Steel Co. (1887), 120 U. S. 649; s. c. 30 Am. & Eng. R. R. Cas. 472.

[7] Antietam Paper Co. *v.* Chronicle Pub. Co. (1894), 115 N. C. 143; s. c. 20 S. E. Rep. 367.

Nor will failure to publish the notice required by statute to be given to stockholders before mortgaging corporate property invalidate the mortgage as to third parties where no stockholder objects.[1]

Creditors, however, may take advantage of the omission to register the mortgage, provided they raise the issue by an appropriate allegation in the bill. As registration is necessary only as to creditors without actual notice, the party claiming under a mortgage may rely on the allegation that the creditor had such notice.[2]

The validity of a mortgage which was executed for the express purpose of defrauding subsequent creditors may, of course, be assailed by any of them upon that ground.[3]

§ 182. **Receivers.** — A receiver has sufficient interest in the property under his charge to raise a question as to the validity of a mortgage or the sufficiency of the consideration of the debt secured thereby as a defence to a foreclosure suit brought by the owner of all the claims against the company.[4]

§ 183. **Purchasers at the Foreclosure Sale.** — These cannot question the authority of the company to make the mortgage, inasmuch as the validity of their own claims depends upon the validity of the mortgage.[5]

For similar reasons the validity of a mortgage, in so far as it is dependent on the validity of the incorporation of the mortgagor company, cannot be questioned by a trustee of the road who derives his title through various mesne assignments commencing with a sale by the mortgagor. "It does not lie in the mouths of such a transferee to dispute the existence of the corporation whose acts constitute his own sole source of title." [6]

§ 184. **The State.** — The State is estopped to dispute the validity of a mortgage which it has authorized after third parties have acquired rights under it.[7]

[1] Central Trust Co. *v.* Condon *et al.*, C. C. A. (1895), 67 Fed. Rep. 84.

[2] Allen *v.* Montgomery & West Point R. Co. (1847), 11 Ala. 437. This answer, however, would presumably not be open where the mortgage is on chattels, and the statute peremptorily declares it to be void unless registered. See § 171, *ante*.

[3] Coe *v.* East & West R. Co. of Alabama (1892), 52 Fed. Rep. 531, where the court refused relief to a creditor for the reason that the rights of the bondholders had become fixed before his claim arose, and no fraudulent design was alleged.

[4] Ryan *v.* Anglesea Ry. Co. (N. J. Eq. Feb., 1888), 3 Ry. & Corp. L. J. 426.

[5] Morgan *v.* Donovan (1879), 58 Ala. 241; s. c. 21 Am. Ry. Rep. 109.

[6] Beekman *v.* Hudson River West Shore R. Co. (1888), 35 Fed. Rep. 3.

[7] Vicksburg, Shreveport, & Pac. R. Co. *v.* Sledge (1889), 41 La. Ann. 896, 902; s. c. 6 So. Rep. 725; Mower *v.* Kemp

(1890), 42 La. Ann. 1007; s. c. 8 So. Rep. 830; 46 Am. & Eng. Corp. Cas. 480.

The following are some of the statutes of different States authorizing mortgages of the property of railroad companies: Ala., Code 1886, § 1580, subd. 14. Ark., Dig. 1894, § 6168. Cal., Civ. Code, § 456. Colo., St. 1891, ch. 30, § 476. Conn., Gen. St. 1888, § 344, Consolidated companies, power to mortgage; §§ 3570–3580, Execution of. Fla., Rev. St. 1892, § 2241. Ga., Code 1882, § 1689 (*i*). Idaho, Comp. L. 1887, § 2664. Ill., Rev. St. 1891, p. 1143, § 20, subd. 10. Ind., Rev. St. 1888, § 3911, Power to mortgage. Iowa, Code, §§ 1965, 1996, Mortgage of benefits from certain contracts of leases, etc. Ky., Gen. St. 1887–1894, § 771. La., Rev. L. 1884, § 692. Me., Rev. St. 1883, ch. 51, § 56. Md., Pub. Gen. L. 1888, art. xxiii. p. 171. Mass., Pub. St. 1882, ch. 112, §§ 62 to 73. Mich., How. Ann. St. 1882, § 3352. Minn., Gen. St. 1891, § 2529. Miss., Rev. Code, § 3586. Mo., Rev. St. 1889, § 2543. Mont., Civ. Code 1895, §§ 899, 913, Chattel mortgage. Nebr., Comp. St. 1895, § 4018, Mortgage of an extension; § 1823, Record; § 1821, Covers rolling-stock; §§ 1759, 1820. Nev., Gen. St. 1885, p. 849. N. J., Suppl. to Rev. 1877 to 1886, p. 824, § 12. New Mex., Comp. L. 1884, § 2665, subd. 14. N. Y., Rev. St. 8th ed. p. 1752, § 10; L. 1868, § 1, Chattel mortgage. N. C., Code 1883, § 1957, subd. 10. N. Dak., Code 1895, § 2947 (11). Ohio, Rev. St. 1890, §§ 3286, 3290, 3309 *a*, 3398, Lien of mortgage postponed to certain claims. Okl., St. 1893, § 1011. Pa., Br. Purd. Dig. 1883, p. 1422, §§ 41, 1436. So. Dak., Comp. L. 1887, § 2981. Tenn., Code 1884, §§ 1251, 1271, Liens preferred to mortgage. Tex., Civ. St. 1888, § 4219. Utah, Comp. L. 1888, §§ 2368, 2369, The lien of the mortgage. Vt., St. 1894. Va., Code 1887, § 1232. Wash., Code 1891, ch. 135. W. Va., Code, p. 520, § 50, subd. 11, 12. Wis., Ann. St. § 1828, subd. 10. Wyo., Rev. St. 1887, p. 206, § 549.

On power to issue English debentures, see Mersey Ry., *In re*, 1895, 2 Ch. Div. 287, Debenture stock; Campbell's Case, 4 Ch. Div. 470, Issue debentures at discount; also Webb *v.* Shropshire Ry. Co. (1893), 3 Ch. Div. 307; Robison *v.* Coal Cliff Co., 12 New South Wales Rep. (Eq.) 293, Debentures ordered issued by court secured on property after two prior mortgages.

CHAPTER IX.

INSTRUMENTS CONSTITUTING MORTGAGES.

§ 185. **Mortgages directly to Bondholders.** — The ordinary mortgage by which the payment of railroad bonds is secured is in the form of a conveyance to a trustee, the instrument reciting that the mortgage is made to him in trust to secure the bonds described to the holders thereof. Such bonds have been executed directly to the creditors who make the loan, and are not invalid on that ground.[1] But a holder of a portion of bonds executed in this form, and secured by a mortgage which states the name of each creditor and the amount of the debt covered by the lien, will not be allowed, even when professing to act in behalf of all bondholders who may come in and contribute to the expenses of the suit, to proceed alone against the company, and ask a sale of the mortgaged property, where it is doubtful whether that property is of sufficient value to secure the whole debt. In such a case it is the interest of each bondholder to diminish the debt of the others, and it is therefore proper that every bondholder should be present, both that he may defend his own claims and that he may attack the other claims, should there be any just occasion for it.[2]

§ 186. **Trust Deeds constituting Mortgages.** — Wherever a mortgage in the form of a trust deed has been recognized and sanctioned by the courts, a grant by the legislature of the power to mortgage will be deemed to embrace the power to execute that kind of mortgage.[3]

[1] Wright *v.* Bundy (1858), 11 Ind. 398.

[2] Railroad Co. *v.* Orr (1877), 18 Wall. 471. For a case where the bonds of a company were considered as mortgages, see King *et al.* *v.* Tuscumbia, C. & D. R. Co. (1846), 7 Pa. L. J. 166; s. c. 14 Fed. Cas. 554, Case No. 7808.

[3] Central Gold Mfg. Co. *v.* Platt (1870), 3 Daly, 263; Pullan *v.* Cincinnati & Chicago Air Line R. Co. (1865), 4 Biss. 35; Wright *v.* Bundy (1858), 11 Ind. 398.

The legal effect of a trust deed of the ordinary kind is that of a contract between the company and all persons who may become holders of the bonds thereby secured, whereby they become entitled to the same benefits as if they were parties to the deed.[1]

The true consideration of such a deed is, not the recital, which it contains, of the resolution of the directors authorizing the bonds to be executed, but the fact of its being a security for the bonds issued in conformity with that resolution.[2]

Such a trust deed, being a *de facto* mortgage, protects the property conveyed thereby as effectually as a deed actually executed as a mortgage, and the trustees may obtain an injunction restraining a levy upon the property.[3]

So also, on the familiar equitable principle, "once a mortgage, always a mortgage," a trust deed of this kind is affected with the usual incidents of a mortgage, and the grantor company has, therefore, an equity of redemption, which, if that species of property is subject to execution, may be levied upon and sold. Such a sale will not be enjoined at the instance of the trustee.[4]

§ 187. **Instruments operating as Equitable Mortgages.** — An equitable mortgage may be constituted by any writing from which the intention to create it may be gathered.[5]

Thus bonds which purport to pledge the real and personal property of a company for the payment of a debt, and contain various other corresponding stipulations, will be treated by a court of equity as a mortgage.[6]

So a recital in a debenture bond that "the company hereby charges with such payment (*i. e.* of the debentures) its under-

[1] Butler *v.* Rahm (1877), 46 Md. 541; s. c. 18 Am. Ry. Rep. 86; McLane *v.* Placerville & Sacramento Valley R. Co. (1885), 66 Cal. 606; s. c. 26 Am. & Eng. R. R. Cas. 404.

The construction of the provisions of the California Code in regard to mortgages was extensively discussed in the case of Southern Pac. Co. *v.* Doyle (1882), 11 Fed. Rep. 253, and it was held that a conveyance of railroad lands to M. and T. in trust to secure the payment of certain "first-mortgage bonds," in the usual form of a mortgage, except that it was with a condition of defeasance, providing that upon the payment of the bonds "the indenture and the estate thereby granted should cease and determine, there being a reservation to the grantor of the sole and exclusive management and control" of the lands, and a provision for entry, foreclosure, and sale by the trustees only upon default and subsequent demand by the bondholders, was in substance a mortgage within the meaning of the Code. Until such default and demand, therefore, the right of possession remained in the mortgagor.

[2] Butler *v.* Rahm (1877), 46 Md. 541; s. c. 18 Am. Ry. Rep. 86.

[3] Loudenslager *v.* Benton (1861), 4 Phil. 382.

[4] Coe *v.* Johnson (1862), 18 Ind. 218; Coe *v.* McBrown (1864), 22 Ind. 262.

[5] Chase *v.* Peck (1860), 21 N. Y. 581; Payne *v.* Wilson (1878), 74 N. Y. 348.

[6] White Water Valley Canal Co. *v.* Vallette (1858), 21 How. 414.

taking, all its property, whatsoever and wheresoever, both present and future," creates an equitable mortgage as between the parties.[1]

So if a corporate officer, acting within the scope of his agency, fails, owing to the non-observance of certain technical requisites, to execute a mortgage effectual to convey the legal estate, the transaction will be regarded as an equitable mortgage, and enforced for the benefit of the bondholders.[2]

So if a company promises to make a mortgage of a railroad, and thereafter goes into possession and operates it, this promise will, in equity, be a mortgage as between the parties.[3]

So it is held that stipulations in a contract with a contractor for mortgages to secure such sums as are specially mentioned in the contract, raise the implication that no other or different mortgage or lien was to be given, and have the effect of a mortgage to the extent indicated.[4]

So an agreement which, for the expressed purpose of securing payments to agents deputed to buy railroad iron, pledges the real and personal estate of the company to these agents, constitutes an equitable mortgage.[5]

So where a junior trust-mortgage provided that no bonds

[1] Howard *v.* Iron & Land Co. of Minnesota (1895), 62 Minn. 298; s. c. 64 N. W. Rep. 896.

[2] Miller *v.* Rutland R. Co. (1863), 36 Vt. 452.

[3] Texas Western R. Co. *v.* Gentry (1888), 69 Tex. 625; s. c. 33 Am. & Eng. R. R. Cas. 46; 8 S. W. Rep. 98.

The court said: "Every express agreement in writing, whereby the party clearly indicates an intention to make some particular property therein described a security for a debt, creates an equitable lien upon the property which is enforceable. The form of the writing is not important, provided it sufficiently appears that it was thereby intended to create a security. If that intention appears, it will create a mortgage in equity, or a specific lien on the property so intended to be mortgaged," citing Pom. Eq. Jur., §§ 1235, 1236; Payne *v.* Wilson (1878), 74 N. Y. 348; Daggett *v.* Rankin (1866), 31 Cal. 321; Canal Co. *v.* Vallette (1858), 21 How. 414. Further on the Minnesota court said: "The Iron & Land Company is an English company, and these debentures were evidently intended to be issued under the provisions of their 'Companies Clauses Act' of 1863, which regulates the creation of debenture stock or bonds in companies, and makes it a firm charge on the undertaking. The evident purpose, as well as effect, of the provisions of these debentures is to create a charge in the nature of a floating mortgage, as security for their payment, upon all the property of the company, present or future, but which would in the meantime leave the company at liberty to sell and dispose of any of it in the course of its business, free from the incumbrance of the mortgage, without being required to apply the proceeds to the payment of the mortgage debt. As we have no such statute, it is quite evident that such a form of security is in many respects wholly unsuited to this State, and that very serious questions will arise as to its validity or effect as against creditors and subsequent purchasers."

[4] Waco & Tap. R. Co. *v.* Shirley (1876), 45 Tex. 355; s. c. 13 Am. Ry. Rep. 233.

[5] Mobile & Cedar Point Ry. Co. *v.* Talman *et al.* (1849), 15 Ala. 472.

should be issued thereunder until holders of the prior mortgage-bonds to a specified amount should have signed an agreement to the effect that bonds secured by the junior mortgage might be issued, such bonds to constitute a lien on the property taking precedence of the bonds held by the signers of the agreement, it was held that the agreement, when signed by the holders of bonds to the amount specified, operated as an equitable mortgage covering the interests which the signers had under the first mortgage, and taking precedence of the latter, but that it in no way affected the interest of the bondholders who did not sign it, and the priority of their lien.[1]

Contractors proposed to construct a railroad upon condition that they should assume one-fourth the cost of construction and subscriptions to stock obtained, and the subscribers to assume three-fourths. Subscribers agreed, and contracted with the promoters that their subscriptions should be loans bearing interest, and maturing at a certain date, to be paid as soon as securities of the company could be negotiated, the subscribers to own a three-fourths interest in the grade if the securities were not negotiated on maturity of the loan. This contract was held to be a mortgage of three-fourths interest in the grade.[2]

§ 188. **Liens in Favor of the State.** — As to liens declared by statute in favor of the State, see Chap. XIII., *post*.

[1] Poland *v.* Lamoille Valley R. Co. *et al.* (1879), 52 Vt. 144 ; s. c. 4 Am. & Eng. R. R. Cas. 408.

[2] Armstrong *et al.* *v.* Burkitt *et al.* (Tex. Civ. App. 1896), 34 S. W. Rep. 759. As to authorization of a corporate mortgage, see Hayden, Trustee, *v.* Lincoln City Electric Ry. Co. (1895), 43 Neb. 680 ; s. c. 62 N. W. Rep. 73.

CHAPTER X.

WHAT THE MORTGAGE COVERS, INCLUDING AFTER-ACQUIRED PROPERTY.

§ 189. **General Statement.** — In determining the effect of clauses of railroad mortgages which cover "after-acquired" property, there must be considered, first, what property the company had power to mortgage; second, what property it intended to mortgage; third, the effect of the words which were descriptive of the property alleged to be covered. In Compton *v.* Jesup[1] it was remarked by the circuit judge (Taft) who delivered the opinion that the extent of the property included in the grant of a mortgage depended on the first two of these questions. The authorities cited in the following chapter are amply sufficient to show that the third question is equally important in the case of after-acquired property. In fact the learned judge, by implication, admits this when he says in another place that there was no controversy possible as to the identity of the property under discussion. If there had been any controversy as to its identity, the third question would have demanded an answer as well as the others. The inquiries respecting the intention of the grantor and the adequacy of the description are, however, of very different importance, according as the subject-matter of the mortgage was owned by the mortgagor at the time the instrument was executed, or was subsequently acquired. In the former case the intent of the grantor is the paramount consideration, and if the intent to embrace property not mentioned in terms is reasonably apparent, effect will be given, in favor of the mortgagee, to a general description, not only against the grantor himself, but

[1] 68 Fed. Rep. 263, 286 (1895).

against subsequent purchasers and creditors, except, of course, in so far as this result may be controlled by the rules regarding notice, and, in the case of personal property, regarding constructive fraud. As was remarked in Mississippi Valley Co. *v.* Chicago, St. Louis, & N. O. R. Co.,[1] a man or a corporation may well mortgage "all property" then owned, "without further words of description, because the fact of present ownership serves as an indicator." On the other hand, if the instrument purports to cover after-acquired property, even though the intent to convey the grantor's whole estate, present as well as after-acquired, may be unquestionable, a court will not fasten the lien on the latter portion of the property, unless it is either specifically described, or so connected, visibly and physically, with the former portion, or so essentially necessary for the conduct of the business in which the mortgagor is engaged, that third parties may fairly be presumed to understand that it is subject to the lien.[2]

ARTICLE I. — GENERAL RULES OF CONSTRUCTION.

§ 190. **Introductory.** — Usually the crucial question involved in defining the scope of the mortgage lien is, whether the description is sufficiently specific to pass the property alleged to be covered. But before entering upon this part of the subject it will be convenient to group together the cases which illustrate the application of some of the common rules of construction to railroad mortgages.

§ 191. **General Laws the Standard.** — The validity and effect of railroad mortgages must be determined by the charters of the companies, so far as they supersede general laws. But the general laws will be applied in the construction and enforcement of such mortgages when lawfully made, unless they are suspended by special legislation.[3]

[1] 58 Miss. 896 (1881).

[2] In the Mississippi case just cited it was observed that "neither a man nor a corporation can, by general terms only, mortgage, so far as subsequent purchasers and creditors are concerned, everything that may thereafter be acquired, through all time; for this would be a mere pledge of the capacity of acquisition, and would afford no sort of indication of what was to pass under the instrument." The rest of the statement in the text is amply sustained by the rulings referred to in the following sections of this chapter. See an article entitled "After-acquired Rolling-stock is Subject to Mortgage," by Leonard A. Jones, in 4 So. L. Rev. N. S. 199. See, for a rule of construction, Maxwell *v.* Wilmington Dental Mfg. Co. (1896), 77 Fed. Rep. 938, in which case *In re* Panama, N. Z. & A. Royal Mail Co., 5 Ch. App. 318, was distinguished.

[3] Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush (Ky.), 673; s. c. 18 Am. Ry. Rep. 221.

§ 192. **Lex Loci.** — If the mortgage to be construed embraces property situated in two States, and there is no proof as to the place of its execution, a court will not be bound by the rule of comity to adopt the construction given by the courts of one of those States to a similar mortgage, but will presume that the courts of other States will construe the instrument in accordance with common-law principles.[1]

§ 193. **Construction a Question for the Court.** — A mortgage is subject to the general rule which makes the construction of all written instruments matter to be passed on by the court and not the jury.[2] It has been held, however, that a finding by a court of first instance, that a certain mortgage embraces property on which a prior lien is claimed, is not erroneous as stating a conclusion of law, and not a conclusion of fact. For such a purpose the issue as to whether an instrument is operative as a mortgage is deemed to present a mixed question of law and fact, like the issues whether a given instrument is the last will and testament of an alleged testator, or whether one claiming as heir or executor is entitled to a particular estate.[3]

§ 194. **All the Writings must be construed together.** — The rule that the meaning of a written contract is to be ascertained by a consideration of all the writings executed by the parties is peculiarly applicable to the instruments discussed in this treatise. The rights of holders of railroad bonds are almost always dependent upon the effect of two instruments, — the bonds themselves and the mortgage securing them. Both must, therefore, be construed together as part and parcel of the contract.[4] (See also Chap. II., § 22.)

The bonds cannot be excluded from the security of the mortgage merely on the ground that the latter instrument does not specify the date of the bonds it is alleged to secure, provided those bonds are in all other respects clearly described therein, and there is nothing in its terms inconsistent with the fact that they had been executed. Whatever ambiguity or doubt may arise in such a case is removed by parol evidence that no other bonds were executed or issued by the company than those with which the mortgage is sought to be connected.[5]

[1] Miss. Valley & Western Ry. Co. *v.* United States Express Co. (1876), 81 Ill. 534.

[2] Parsons on Contr. *492.

[3] Binkert *et al.* *v.* Wabash Railway Co. (1881), 98 Ill. 205.

[4] Benjamin *v.* Elmira, Jefferson, & Canandaigua R. Co. (1867), 49 Barb. 441.

[5] Butler *v.* Rahm (1877), 46 Md. 541; s. c. 18 Am. Ry. Rep. 86.

§ 195. **General Words followed by Particular (Expressio unius, etc.).** — Where a mortgage in describing property employs at first general terms, and afterwards proceeds to describe particularly each thing mortgaged, the latter description will control the former, if there be a repugnancy, the rule being that, in a deed, specification generally includes things not specified. Thus a mortgage of "property," with a specific description of the different kinds, does not cover municipal aid-bonds not embraced in the description.[1]

But this rule is subject to the qualification that the omission to specify a thing without which the things specified would be of no value does not exclude the thing omitted.[2]

So also, where a general reference to certain property has been inserted, it will not be limited by the addition of a clause referring to property of that kind which may afterwards be acquired with the proceeds of the bonds. Such a clause is merely intended to remove any doubt which may possibly arise as to whether the property thus purchased would also go to increase the security offered.[3]

§ 196. **Particular Words followed by General (Verba ejusdem generis).** — The familiar rule of statutory construction, that where several words preceding a general expression point to a confined meaning, the general expression shall not have such a meaning as to extend the effect beyond subjects *ejusdem generis*, is sometimes applied to descriptions in railroad mortgages. Thus it has been held that the effect of a mortgage of after-acquired property, containing the following words: "All the articles of personal prop-

[1] Smith *v.* McCullough (1881), 104 U. S. 25. Harlan, J., said: "But the rules established for the interpretation of written instruments will not justify us in detaching these general words from those of an explanatory character which immediately follow in the same sentence. The subsequent phrase 'that is to say,' followed by a detailed description of the different kinds of property which are embraced by the general words quoted, indicates that the mortgage was not intended to embrace every conceivable possession and right belonging to the railway company, but only the road and its adjuncts and appurtenances. It specifies different kinds of property, some of which would enter into the construction of the branch road and some of which would necessarily be employed in its maintenance after completion. The "rights, privileges, and franchises" mortgaged were, it seems to us, only such as had direct connection with the management and operation of the road after it was constructed and put in use as a public highway. There was no purpose, we think, to pass the mortgagee any interest whatever in municipal subscriptions which had been previously obtained and accepted by the company for the purpose of raising money to build a road."

[2] Pullan *v.* Cincinnati & Chicago Air Line R. Co. (1865), 4 Biss. 35, applying the rule so as to bring rolling-stock under the lien of a mortgage in which it was not specified.

[3] Shaw *v.* Bill (1877), 95 U. S. 10.

erty acquired by the company since the date of the mortgage, consisting, among other things, of the following, to wit," etc., after which followed an enumeration by name of several engines, and, by number, of several different kinds of cars, must be restricted to articles of the same nature as those specifically named.[1]

So also, when the comprehensive phrase "all other property" is used neither at the beginning nor the end of the granting clause, but in a position where its proper function is evidently to remove any doubt there might be as to whether certain miscellaneous articles in and around certain specified parts of the premises are covered, its use is limited to explaining the words with which it is immediately connected, and it cannot be construed so as to extend the lien to town lots not coming within the specified description contained in the instrument.[2]

If, however, it appears from a consideration of the entire instrument that it was the intention of the parties to give the words of general description a wider reach than the application of this rule would indicate, that intention must prevail.[3]

Article II. — What is a Sufficient Description to pass Property owned when the Mortgage is executed.

§ 197. **The Entire Property will pass by an Appropriate Generic Description in a Mortgage.** — As most railroad mortgages have been executed for the express purpose of construction, the cases in which their effect, as regards property owned at the time of their execution, is discussed are naturally few in number. The general rule is that, as already stated, the fact of present ownership sufficiently identifies the property to admit of its being conveyed by the most general words, if such appears to be the intent of the grantor. Whether the property is necessary to the enjoyment of the franchises is entirely beside the question. The duty of the court is confined to ascertaining the true construction of the instrument without regard to any extraneous considerations. Thus, where the granting clause covers "all and singular the estate and property real," together with "all and singular the lands, etc., rights, and interests, real estate," etc., all the lands

[1] Brainerd *et al.* *v.* Peck & Colby (1861), 34 Vt. 496.

[2] Alabama *v.* Montague (1885), 117 U. S. 602; s. c. 6 Sup. Ct. Rep. 911.

[3] Raymond *v.* Clark (1878), 46 Conn. 129, where the mortgage was held upon this principle, to cover some office furniture. Whether this property comes under the protection of the principle that things necessary for the operation of the road are covered (see below) was a question which was discussed and answered in the affirmative in Buck *v.* Seymour (1878), 46 Conn. 156.

belonging to the company will pass without regard to the purpose for which they may be used.[1]

The word "franchise," however, is not one which will be construed as implying an intent to cover the whole property of the company, unless, perhaps, by those courts which have adopted the theory that a railroad and its franchises constitute an entire indivisible thing.[2]

Hence a mortgage covering a "railroad and franchises, also all the station-houses, etc., and other appendages, with all the lands belonging to and intended for the use and accommodation of the road," will only cover property connected with the road.[3]

§ 198. **Mortgage covers whatever is necessary to the Enjoyment of the Thing granted.** — The right to carry on the business of a colliery company, occupying mineral land as a lessee, passes under a mortgage, expressed to be the company's lands, mines, coal, and other premises described in certain leases referred to, with its buildings and fixed machinery. Under any other construction the mortgagee would virtually have no security, for the value of the property consists in its being kept up as an active concern, and a cessation of work would enable the lessor to put an end to the lease by re-entry.[4] Such a case is entirely different from one where there is a mortgage of a house or a hotel which does not pass the business of the mortgagor or the goodwill.[5]

§ 199. **The same Rule prevails as to the Construction of a Lien declared by Statute in Favor of the State.**[6] — Thus a lien declared in favor of the State as security for its aid, in which the sweeping phrase "the road and property of the company" is used, will cover lands granted by Congress to a State, and by the State to the company, for the purpose of raising money to construct the road, although the lands are in no way connected with the operation of the road.[7]

[1] Robinson *v.* Atlantic & Great Western Ry. Co. (1870), 66 Pa. St. 160.

[2] See § 200, below.

[3] Eldridge *v.* Smith *et al.* (1861), 34 Vt. 484.

[4] County of Gloucester Bank *v.* Rudry Merthyr, etc. Co. (1895), L. R. 1 Ch. 629.

[5] Whitley *v.* Collis (1892), L. R. 1 Ch. 64.

[6] See generally as to these liens, Chap. XIII., *post.*

[7] Wilson *v.* Boyce (1875), 92 U. S. 320. In the recent case of Wilson *v.* Beckwith (1893), 117 Mo. 61; s. c. 22 S. W. Rep. 639, a contrary ruling as to another portion of these lands was made, but the court expressly disclaimed any intention to throw doubt upon the propriety of the general principle of construction applied in Wilson *v.* Boyce, and based its opinion upon its views as to the effect of the acts of Congress relating to those lands.

In Whitehead *v.* Vineyard (1872), 50 Mo. 29, 30, the same words were held to cover after-acquired lands as well, though not connected with the operation of the road. This ruling was also based upon a consideration of all the legislation upon the

Article III. — Principles upon which Mortgages purporting to convey After-acquired Property are enforced.

§ 200. **General Principle that of an Executory Contract.** — The doctrine of equity with regard to the effect of the after-acquired property clause of a mortgage is that it amounts to an executory contract on the part of the mortgagor that, as soon as the property embraced therein comes into existence, he will subject it to the lien of the mortgage.[1]

The general rule as to the effect of a mortgage containing such a clause was announced in the following terms by Mr. Justice Story as early as 1843: "It seems to me a clear result of all the authorities, that wherever the parties by their contract intend to create a positive lien or charge, either upon real or personal property, whether it is then *in esse* or not, it attaches in equity as a lien or charge upon the particular property as soon as the assignor or contractor acquires a title thereto, against the latter, and all persons asserting a claim thereto under him, either voluntarily, or with notice, or in bankruptcy."[2]

The doctrine thus formulated was applied to a railroad mortgage in 1857 by the Supreme Court of New York,[3] which also adopted as an alternative ground for its ruling the theory of Pierce *v.* Emery,[4] that a railroad and its franchises might be regarded as an entirety.

The question as to the validity of such a clause, at least, as against creditors, seems, however, to have been still regarded as an open question, for it was carried to the Supreme Court of the United States very soon afterwards in the well-known case of Pennock *v.* Coe.[5] There Mr. Justice Nelson, after observing that the main argument urged against the validity of the mortgage was founded on the maxim that "a person cannot grant a thing which he has not" (*qui non habet, ille non dat*), and conceding the soundness of the principle that a deed or mortgage, by which

subject of the aid-bonds, and is therefore not inconsistent with the cases which hold that under ordinary circumstances such an indefinite description would not cover after-acquired property. (See below.)

[1] Grape Creek Coal Co. *v.* Farmers' Loan & Trust Co. (1894), 63 Fed. Rep. 891; s. c. 12 C. C. A. 350; Borden *v.* Croak, Admrx. (1889), 131 Ill. 68; s. c. 22 N. E. Rep. 793.

[2] Mitchell, Assignee, *v.* Winslow *et al.* (1843), 2 Story, 630.

[3] Seymour *v.* Canandaigua & Niagara Falls R. Co. (1857), 25 Barb. 284.

[4] 32 N. H. 484 (1856).

[5] 23 How. 117 (1859). The report of this case as Coe *v.* Pennock (1857), in the lower court, will be found in 6 Am. Law Reg. 27; s. c. 3 Fed. Cas. 1172, Case No. 2962. See Lloyd *v.* E. & N. A. R. Co., 18 New Br. 194; Lanark *v.* Cameron, 9 Upp. Can. C. P. 109; Quincy *v.* C., B. & Q. R. Co., 94 Ill. 537.

a party undertakes to grant, *in presenti*, property which does not belong to him or has no existence, is inoperative and void, either in law or equity, proceeded as follows: "But this principle has no application to the case before us. The mortgage does not undertake to grant, *in presenti*, property of the company not belonging to them or not in existence at the date of it, but carefully distinguishes between present property and that to be afterwards acquired. . . . The inquiry here is, not whether a person can grant, *in presenti*, property not belonging to him and not in existence, but whether the law will permit the grant or conveyance to take effect upon the property when it is brought into existence, and belongs to the grantor, in fulfilment of an express agreement, founded on a good and valuable consideration." The learned justice then points out that if the money raised on the security of the mortgage had been diverted from the purposes to which it should have been devoted, namely, the building of the road and its equipment, a court of equity would have interposed and compelled a specific performance of the agreement. This being the case, it might certainly be concluded with confidence that such a court would sanction the voluntary performance of the agreement by the parties themselves, and give effect to the security as soon as the property was brought into existence. This view being also supported by authorities, both English and American, it was held that the mortgage was a valid security upon the property described therein (rolling-stock), from the time of its acquisition by the company.[1]

The authority of Pennock *v.* Coe does not seem to have been universally admitted at first. Thus we find the Supreme Court of Massachusetts in the following year saying that, if the mortgage of after-acquired rolling-stock in the case under review had not been recognized and ratified by the legislature, it would not have protected the property against an execution. No reference was made to the equitable doctrine.[2] This declaration of the law was diametrically opposed to that of the Supreme Court of the United States, and that court, when the same case came before it, merely referred to Pennock *v.* Coe as being decisive of the doctrine that a mortgage of after-acquired property is, within certain limits, valid against judgment creditors.[3]

[1] In England the validity and effect of assignments of future acquisitions had been clearly expounded in Langton *v.* Horton, 1 Hare Ch. 249 (1842), which was strongly relied upon in Pennock *v.* Coe; but the doctrine did not receive the sanction of the House of Lords until 1860, when Holroyd *v.* Marshall, 10 H. L. C. 190, was decided.

[2] Howe *v.* Freeman (1860), 14 Gray, 566.

[3] Freeman *v.* Howe (1860), 24 How. 450.

At the present time the doctrine of Pennock *v.* Coe is the one which is universally relied upon for the purpose of giving effect to mortgages of after-acquired property, and the theory of Pierce *v.* Emery,[1] which for the same purposes treats the railroad and its franchises as an indivisible whole, is practically exploded.[2] It is possible that the latter theory may have been due not merely to an imperfect realization of the real effect and scope of a comparatively new doctrine, but also to a desire to bring mortgages of after-acquired property within the reach of legal as well as equitable principles. Such a consideration, however, is plainly of no weight where equitable rules are enforced.[3]

§ 201. **Subsidiary Grounds on which the Enforcement of the Executory Contract rests.** — There is some divergence of opinion, or more correctly, perhaps, of statement, as to the *rationale* of the enforcement of executory contracts of this class. Sometimes the principle relied upon is that "equity considers that as actually done which ought to be done."[4] In other cases the operative principle is assumed to be that of estoppel.[5]

This difference of opinion is of little moment, as it merely indicates that the doctrine was considered from two equally possible points of view.

By whatever principle the enforcement of the contract embodied in the after-acquired clause is explained, there is complete unanimity as to the practical result; namely, that the property intended

[1] 32 N. H. 484 (1856).

[2] See §§ 229, 230, below.

[3] Phila., Wilm. & Balt. R. Co. *v.* Woelpper (1870), 64 Pa. St. 366. There it was said: "It is indubitable that a mortgage of land will pass all structures or fixtures that may be afterwards erected upon it by the mortgagor. But it is not necessary to maintain that the rolling-stock and equipment of a railroad are part of its accretions and fixtures, so as to make the transfer good at law. It is unquestionably good in equity."

[4] Phila., Wilm. & Balt. R. Co. *v.* Woelpper (1870), 64 Pa. St. 366; Williamson *v.* New Jersey Southern R. Co. (1878), 29 N. J. Eq. 311; Little Rock & Fort Smith Ry. Co. *v.* Page (1880), 35 Ark. 304; s. c. 7 Am. & Eng. R. R. Cas. 36; Seymour *v.* Canandaigua & Niagara Falls R. Co. (1857), 25 Barb. 284.

[5] Galveston Railroad *v.* Cowdrey (1870), 11 Wall. 459. There the court, speaking of three deeds of trust, said that they *estopped* the company and all persons claiming under it and in privity with it from asserting that those deeds did not cover all the property and rights they professed to cover. "Had there been but one deed of trust," it was remarked, "and had that been given before shovel had been put into the ground towards constructing the railroad, yet if it assumed to convey and mortgage the railroad, which the company was authorized by law to build, together with its superstructures, appurtenances, fixtures, and rolling-stock, these several items of property as they came into existence would become instantly attached to and covered by the deed, and would have fed the estoppel created thereby." Similar language is used in Scott *v.* Clinton & Springfield R. Co. (1876), 6 Biss. 529.

to be covered becomes subject to the lien the instant it becomes a portion of the corporate effects.[1]

Article IV. — What is a Sufficient Description to pass Property acquired after the Mortgage is executed. General Rules stated.

§ 202. **The Requirement of a Specific Description in the Case of Future Acquisitions, upon what Principle based.** — From the principle that the enforcement of the lien of the after-acquired clause is essentially the enforcement of an executory contract, it necessarily follows that the terms of that contract must satisfy the conditions which a court of equity exacts as a prerequisite to granting a decree of specific performance. The most important of those conditions in the present connection is that the property intended to pass should be described with reasonable certainty. "The contract must relate to some particular property described in the mortgage, which, though not in existence, must be reasonably certain to come into existence, so that the minds of the parties may be in agreement as to which it is to be. The mortgagor must have a present actual interest in it or concerning it. There must be something *in presenti*, of which the thing *in futuro* is to be the product, or with which it is to be connected, as necessary for its use, or as incident to it, constituting a tangible existing basis for the contract."[2] Similarly it was observed in a case decided by the Supreme Court of New York two years before the leading case of Pennock *v.* Coe: "It must be the intention of the parties to create a lien, and the lien must have a specific reference, and must necessarily apply to some designated property, either *in esse* or in expectancy, and this clearly and unmistakably. Unless the agreement or mortgage plainly describes or designates particular lands, it will be regarded as a mere executory contract and enforceable only as such."[3] (By "executory contract" is clearly meant one binding upon the person and general estate of the grantor, as opposed to a contract of that description binding upon some specific property.)

[1] Benjamin *v.* Elmira, Jefferson, & Canandaigua R. Co. (1867), 49 Barb. 441; Morrill *v.* Noyes (1863), 56 Me. 458; Parker *v.* New Orleans, B. R. & V. R. Co. (1888), 33 Fed. Rep. 693; Meyer *v.* Johnston (1875), 53 Ala. 237; Galveston Railroad *v.* Cowdrey (1870), 11 Wall. 459, 481; Barnard *et al.* *v.* Norwich & Worcester R. Co. (1876), 4 Cliff. 351; Williamson *v.* New Jersey Southern R. Co. (1875), 25 N. J. Eq. 13; Dunham *v.* Cincinnati R. Co. (1863), 1 Wall. 254; United Lines Telegraph Co. *v.* Boston Safe Deposit & Trust Co. (1893), 147 U. S. 431; s. c. 13 Sup. Ct. Rep. 396.

[2] 23 How. 117 (1859).

[3] Seymour *v.* Canandaigua Niagara Falls R. Co. (1857), 25 Barb. 284.

Similar language has been used by English judges. After-acquired property, it has been said, will not come under the lien in the absence of some words expressive of the intent that it shall so pass,[1] and the lien will not take effect, as against adverse parties, unless that intent is declared by apt terms, or a sufficient context.[2]

§ 203. **The Requirement of a Specific Description to pass after-acquired Property, applicable to Statutory Liens.**[3] — This necessity for a specific description exists not only in the case of ordinary mortgages, but also in the case of those liens in the nature of mortgages which are fastened by statute upon the railroad property, as a security for State or municipal aid. On this ground it has been held that after-acquired property is not covered by the lien created by an act which provides that "all liabilities which by said city may be assumed or incurred under or by virtue of any of the provisions of this act shall *at the time*, and by force thereof and for security and payment of the same, create in favor of said city a lien in the whole of said railroad, its franchises and all its appendages, and all real and personal property of said railroad corporation." The court said: "Acts creating liens should not be construed to attach to after-acquired property any more than grants or mortgages, unless such is the plain meaning of the language used. The language used includes such a construction. The lien provided for in this section is to take effect at the time the liability is assumed, and cannot be held to include property not then owned by the company.[4]

In Tennessee, however, it has been held that a lien declared by statute upon "the entire road, including the stock, right of way, grading, etc., and all the property, owned by the company as incident to or necessary to its business," embraces not only the properties of the description designated which were in existence at the time the mortgage took effect, but also properties of that kind which may afterward come into existence and be acquired by the company.[5]

[1] *In re* New Clydach, etc. Co. (1868), L. R. 6 Eq. 514.

[2] Bank of South Australia *v.* Abrahams L. R. 6 P. C. 265.

[3] As to these liens generally, see Chap. XIII., *post.*

[4] City of Bath *v.* Miller (1865), 53 Me. 308.

[5] McGraw *v.* Memphis & Ohio R. Co. (1866), 5 Coldw. (Tenn.) 434. This decision is not based expressly on the ground that a legislative grant, if its meaning is doubtful, should be construed in favor of the State (Rice *v.* Railroad Company (1861), 1 Black, 358), but on the secondary consideration, perhaps deemed by the court to be a justifiable deduction from that principle, — that if the effect of the mortgage were to be limited to the former class of property, the

§ 204. **Application of General Principles to Property acquired and not required for Railroad Purposes.** — The degree of precision required in the language employed depends entirely upon whether the property alleged to be covered was acquired for necessary railroad purposes, or, in other words, to be used in facilitating the discharge of the company's function as a common carrier. If the property was acquired to be employed in this manner, it will pass under a generic description, the fact of its forming a part of the railroad being deemed sufficient to identify it and distinguish it from other property of the same kind owned by others.

If, on the other hand, the property has no immediate connection with the operation of the road, a merely generic description will not fasten a lien upon it. The language used must in this case be sufficiently specific to designate the property without reference to extraneous circumstances. This distinction is fundamental, and pervades all the cases which turn upon the sufficiency of the description.

The rule that a generic description is effectual to this extent is of course subject to be controlled by words which show an intent to limit the lien in some way, and is not applicable where the description of the mortgage, by its precise terms, limits the property (in this case, lands) to those lying between certain termini in a specified State.[1]

It has been said that there is not the same necessity for a particular description in railroad mortgages as in mortgages by a private person.[2]

But this statement seems to be incorrect. *Mutatis mutandis*, the requisites of a valid mortgage of after-acquired property are the same, whether the mortgagor is a railroad company or an individual.[3]

ordinary wear and tear of the subject-matter would in a few years deprive the State of a large part of its security. This is certainly carrying the doctrine to its extreme limits.

In Buck *v.* Seymour (1878), 46 Conn. 156, it was held that, where the directory of a company, under a general statute authorizing trustees in such a case to take possession, surrendered to the trustees with a written declaration that they surrendered all the property covered by the mortgage, such a surrender constructively included the property acquired after the date of the mortgage; and that a delivery of the after-acquired property for the benefit of the bondholders created a lien in their favor upon it, even if the mortgage had not been sufficient for that purpose.

[1] Chapman *v.* Pittsburg & Steubenville R. Co. (1885), 26 W. Va. 299, 328.

[2] Buck *v.* Seymour (1878), 46 Conn. 156.

[3] Compare Parker *v.* New Orleans, B. R. & V. R. Co. (1888), 33 Fed. Rep. 693; Bell *v.* Chicago, St. Louis, & New Orleans R. Co. (1882), 34 La. Ann. 785. The last two cases were decided under the law of Louisiana, which limits the power of the company, as regards mortgages of after-acquired property, to property acquired for railroad purposes (see above, § 200),

The true principle is laid down in Miss. Valley Co. *v.* Chicago, St. Louis, & New Orleans R. Co.,[1] where Chambers, C. J., in delivering the opinion of the court, used the following language: "It is said that a mortgage of a railroad and its future property will carry all after-acquired property appurtenant to and necessary for building and operating the road and carrying out the purposes for which it was created, while a similar instrument will be inoperative if executed by a private person. This is true if the mortgage executed by a private person is upon a specified piece of property, without reference to any accretions or additions to it, because there can be no accretions of property appurtenant to the person of the mortgagor; but it is untrue if the individual has mortgaged his business and the property then appurtenant to, or afterwards to grow out of, and to be added by accretion to the particular business that is pledged. Thus a natural person, equally with a corporation, can execute a valid mortgage of a ship and the profits of its voyage, or of a factory and the machinery then in it or to be placed in it, or of a farm and the products to be produced upon it, or of a flock of sheep and its natural increase and future-grown wool; and so a railroad company can execute in general terms a valid mortgage of its road-bed and franchises, and all of its real and personal property then owned or thereafter acquired, provided the future acquisitions be such as belong naturally to the business of construction and maintaining the road and performing its primary end as a common carrier of passengers and freights. The things which may be deemed essential or useful, and therefore appurtenant to the great work of building and operating a railroad, will frequently be more extensive and varied in their character than those which can properly be regarded as accretions," etc.

The actual decision of the Connecticut case referred to above was quite in harmony with this exposition of principles, as it was merely held that a description of after-acquired property as "all property which may hereafter belong to said company, and be *used as a part of said road*," was not too indefinite, and therefore the distinction drawn between mortgages by railroad companies and private persons was quite uncalled for.

The fact that the comprehensive clause, "and all rights, privileges, franchises, and property whatever, now belonging or hereafter to belong to or to be acquired by said party of the first part," is

and the ruling was that, provided the mortgage was confined by definite terms to such property, the lien would attach to it as effectually as if it had been specifically described in the instrument. The latter case gives a succinct *résumé* of the Civil, French, and Spanish laws on the subject.

[1] 58 Miss. 896 (1881).

added at the conclusion of the granting part of the mortgage, will not be a ground for drawing any other than the usual deduction, that only property used in connection with the railroad, in promoting the direct purposes of its construction, especially where the clause is preceded by a minute description of specific kinds of property, all of which are of that character, and so referred to.[1]

§ 205. **What is Property used for Railroad Purposes.** — Property may come under the category of that used for railroad purposes without being *indispensably* necessary for the proper conduct of the company's business.[2]

It is "necessary," within the meaning of the rule, if it is such as the company, in the reasonable exercise of its discretion, considered it best to procure for the most profitable use of the road, even though the road might have been operated without it.[3]

Instructions embracing the word "indispensably" have, however, been held correct upon appeal.[4]

Mere convenience is certainly not enough to bring property into this category, as where lands are purchased for the sake of the timber on them.[5]

In regard to lands, the proper test has been held to be whether they could or could not have been taken by proceedings in eminent domain for the purposes to which they are applied. In the former case they are covered by the mortgage; in the latter case they are not. Thus the entire surveyed line to its full width will pass, and also land required for piling wood; but not land acquired for the purpose of erecting a car factory, and dwelling-houses for its employees.[6]

[1] State *v.* Glenn (1883), 18 Nev. 34. Compare Hunt *v.* Bullock (1860), 23 Ill. 320, where the court rejected the idea that the word "franchise" would cover such property as wood, coal, writing-desks, stationery, and all kinds of household furniture which might happen to be used by the company in carrying on its business.

[2] Morgan & Raynor *v.* Donovan (1877), 58 Ala. 241; S. C. 21 Am. Ry. Rep. 199.

[3] Buck *v.* Seymour (1878), 46 Conn. 146.

[4] Shamokin Valley R. Co. *v.* Livermore *et al.* (1864), 47 Pa. St. 465.

[5] Dinsmore *v.* Racine & Mississippi R. Co. (1860), 12 Wis. 649. Here the inference was strengthened by the language employed in the instrument, all the lands and real estate spoken of in the mortgage being those upon which the road was to be constructed, or in which the company might acquire the right of way, or lots or parcels of land along the line of the road used or to be used for erecting thereon depots, engine-houses, shops, and all such structures as might be necessary for the operation and business of the road, or upon which drains and embankments might be made for the preservation and protection of the road. Compare Parish *v.* Wheeler (1860), 22 N. Y. 494, and Brainerd *v.* Peck (1861), 34 Vt. 496, summarized below in this chapter.

[6] Eldridge *v.* Smith *et al.* (1861), 34 Vt. 484. The last part of this ruling seems scarcely reconcilable with those which hold that a hotel for the accommodation of passengers and employees may pass under a general description. See § 212, below.

City lots purchased by a railroad company designed for legitimate railroad uses and purposes in certain contingencies will pass under and be covered by a subsequent mortgage covering property present and to be acquired, though the contingencies may never happen, and the lots be not used as originally designed from their unsuitability for railroad purposes.[1]

§ 206. **Property acquired by a Consolidated Company when covered.** — Property acquired by a consolidated company will be subject to the lien of a mortgage made by one of the constituent companies, provided the property is such that it would have passed under the mortgage if the consolidation had not taken place.[2]

Where a mortgage of a street-railway company covers a contemplated extension, it may be enforced against such extension though it may have been constructed by another company which had purchased the franchises, etc., of the mortgagor.[3]

A mortgage on a flume or ditch not completed, but projected and in course of construction, covers the whole work when completed, if the instrument contains apt terms expressing the intent of the mortgagor that it shall have that operation.[4]

Article V. — What is a Sufficient Description to pass After-acquired Interests in Real Estate.[5]

§ 207. **General Rules.** — In many, if not most, instances in which real estate is mentioned it will be found that the mortgage contains expressions which indicate that the draughtsman was designedly composing it in conformity with the general principle stated in the preceding section. If the property is described as that "used or appropriated in operating and maintaining the

[1] Hawkins *et al.* Trustees *v.* Mercantile Trust & Deposit Co. (1895), 96 Ga. 580; s. c. 23 S. E. Rep. 498 (1895). See McTighe *et al. v.* Macon Construction Co. *et al.* (1894), 94 Ga. 306; s. c. 21 S. E. Rep. 701.

[2] Compton *v.* Jesup (C. C. A. 1895), 68 Fed. Rep. 263. The court concluded, from the wording of the earlier mortgages through which the consolidated company deduced its title, that it was the intention of the mortgagors to subject to the liens whatever was added to the railroad at each of the terminal points named for use as part of it. "Every person, therefore, acquiring the railroad thus described, or any interest in it from the mortgagors, took title to the mortgages thus construed, and in making additions or accessions within the terms of the mortgages was estopped by privity of title with the mortgagors to deny that such accretions were subject to the mortgage lien."

[3] Hinchman *v.* Point Defiance Ry. Co. *et al.* (Boyle *et al.*, Interveners), (Wash., 1896), 44 Pac. Rep. 867.

[4] Union Water Co. *v.* Murphy's Flat Fluming Co. *et al.* (1863), 22 Cal. 620.

[5] For a review of the cases in which the effect of the mortgage as regards realty is rather a question of power than of construction, see Chap. VIII.

road," the inference is conclusive that no other property but this can pass under the mortgage.[1] The rule, however, is independent of the effect of phraseology apparently intended to embody it, and cannot be overridden by any description, however comprehensive, which is of a merely generic character. An instructive case on this point, and one which also affords illustration of the circumstances which will place after-acquired land upon one side or other of the line which separates property used in the operation of the road and property not so used, is Miss. Valley Co. *v.* Chicago, St. L. & N. O. R. Co.[2] There a railroad company executed a mortgage of all its property, present and future, in the most comprehensive terms possible, the descriptive clause winding up with the words, "intending hereby to include all its present real and personal estate and franchises now owned or hereafter to be acquired, without any exception or reservation whatever;" and it was argued that the lien covered a hotel, a storehouse, some vacant lots, and a farm of three acres. The words of the mortgage were admitted to be broad enough to cover this property, but it was said that neither a natural person nor a corporation could mortgage property to be acquired in the future by words so vague and general as to afford to creditors and subsequent purchasers no notice whatever of the property to be embraced. The vagueness of the description therefore prevented the clause as to future acquisitions from taking effect as to the particular property alleged to be embraced in the mortgage, and it must be excluded from its operation unless it was appurtenant to the business of the road. This condition, it was held, was not satisfied by a hotel which was not used as an eating-house for passengers, and real estate which was rented out for the several purposes to which it was adapted, the company deriving no benefit therefrom except it received the rents.

§ 208. **General Words limited by subsequent.** — The general terms of an after-acquired clause may be limited by subsequent words showing an intention to restrict the operation of the lien. Thus where an income mortgage includes "all and singular the line of railways belonging or hereafter to belong to" the mortgagor, and then goes on to describe them as extending from certain specified points to others, and the directors are required to set apart for payment of the interest on the income bonds the net income derived from the road, after deducting operating expenses

[1] Walsh *v.* Barton (1873), 24 Ohio St. 28. Compare Boston & New York Air Line R. Co. *v.* Coffin (1882), 50 Conn. 150; s. c. 12 Am. & Eng. R. R. Cas. 375, referred to in the next section.

[2] 58 Miss. 896 (1881).

and betterments necessary to keep the line in first-class condition, the lien of the mortgage attaches only to the roads then belonging or thereafter to be acquired between the termini named, and the directors cannot deduct from the fund for the payment of interest, operating and other expenses incurred on new lines acquired beyond those termini.[1]

The inference that the after-acquired property clause covers only lands acquired for business purposes is sometimes strengthened by some words used in the other parts of the instrument. Thus although the granting clause may purport to cover all future-acquired lands in a certain county, yet if there is an express covenant for further conveyance and assurance which is restricted to future-acquired lands purchased for use in carrying on its business of mining, the mortgage should not be construed to include lands not purchased for that purpose.[2]

§ 209. **Land beyond the Chartered Limits will not pass.**—Agreeably to the principles laid down in the preceding section, it has been held that the mortgage does not cover lands purchased by the company beyond the limit allowed in the charter and never used for its road.[3]

Nor will town lots, unless directly appurtenant to the railroad, and indispensably necessary to the enjoyment of its franchises, pass by a mortgage of a road "with its corporate privileges and appurtenances."[4]

Nor will a mortgage conveying "the railroad then constructed and to be constructed, etc., and all other corporate property, real and personal, of said railroad company, belonging or appertaining to the said railroad, whether then owned or thereafter to be acquired," cover lands granted as an inducement to erect a depot at a certain place, and never used for any railroad purposes.[5]

Nor will the use of the words "necessary and convenient" in connection with the lands which the mortgage purports to convey cover a portion of a lot which was never used for railroad purposes, except as a site for the temporary office during the time when the building ordinarily occupied for that purpose was being re-erected.[6]

[1] Spies *v.* Chicago & Eastern Iowa R. Co. (1889), 40 Fed. Rep. 34; s. c. 40 Am. & Eng. R. R. Cas. 401.

[2] Grape Creek Coal Co. *v.* Farmers' Loan & Trust Co. (1894), 63 Fed. Rep. 891; s. c. 12 C. C. A. 350.

[3] Youngman *v.* Elmira & Williamsport R. Co. (1870), 65 Pa. St. 278.

[4] Shamokin Valley R. Co. *v.* Livermore (1864), 47 Pa. St. 465.

[5] Calhoun *v.* Memphis & Paducah R. Co. (1879), 2 Flip. 442.

[6] St. Louis, Arkansas, & Texas Ry. Co. *v.* Whitaker (1887), 68 Tex. 630; s. c. 5 S. W. Rep. 448.

Similarly where the general words of the description are qualified by such phrases as, "that may be included in the location of said railroad;" "used as a part of said railroad;" "appurtenant thereto;" "necessary for the construction, operation, or security thereof;" "necessary for the completion and operation of the road," — the lien will be confined to the lands which were prospectively necessary and convenient for the construction and future operation of the road, and will not embrace lands situated outside the lay-out of the road, which had been taken over by the company in order to acquire at a less cost the lands actually needed for the line itself.[1]

On the other hand, in deference to the general principle that "the case of a railroad holding more property for its own purposes than its present needs demand, is entirely different from one in which the company buys other property distinct from the road and its appurtenances, not intended or necessary for the present or prospective exercise of its franchise," the court will subject to the lien of a mortgage covering all its property "then possessed or to be thereafter acquired," land purchased for terminal facilities at a time when the company believed it to be required for the accommodation of the road, even though their expectations of business have not been realized, and the land has never been actually put to the use for which it was bought.[2]

It has been already stated that in some early cases a greater latitude of construction was asserted in regard to railroad mortgages, on the theory that a railroad is an indivisible thing. An unsuccessful attempt was made on this ground in Dinsmore *v.* Racine R. Co.[3] to establish the lien of a mortgage upon lands several miles distant from the line which had been purchased for the timber thereon, whether owned at the time of the mortgage or subsequently acquired, whatever condition it might be, provided it was obtained for the necessary use of the road. The court declined to accept this theory, saying, "I cannot adopt this view of a railroad, or think that such is the peculiar nature and character of the property belonging to these corporations. A railroad corporation, with its franchises and property, has undoubtedly many things peculiar to itself. But theoretically I have great difficulty in considering it, with all those franchises and real and personal property, as being one entire and indivisible thing My first conception

[1] Boston & New York Air Line R. Co. *v.* Coffin (1882), 50 Conn. 150; s. c. 12 Am. & Eng. R. R. Cas. 375.

[2] Hamlin *v.* European & North American Ry. Co. (1881), 72 Me. 83; s. c. 4 Am. & Eng. R. R. Cas. 503.

[3] 12 Wis. 649 (1860).

of it is contrary to this idea. A railroad with all its property and franchises cannot, with much precision of language, be likened to a machine or even a vessel. It is an attempt to compare things which have few, if any, points of resemblance. A railroad is defined by Webster to be 'a road or way on which iron rails are laid for wheels to run on for the conveyance of heavy loads in vehicles.' This, I think, is the popular understanding of the term. There is no difficulty in conceiving of a railroad as separate and distinct from its rolling-stock, cars, engines, and depots. The idea of a railroad is complete without these accessories. We speak of the real estate belonging to a railroad, and of personal property belonging to it, without meaning that all these are inseparable from it. They do not form one entire thing which is incomplete without all these accessions. I can understand how a railroad corporation with its franchises may be said to be an entire, indivisible thing, — a unity. But I cannot well conceive how a railroad with all its property, real and personal, of every nature and character, can with accuracy be said to be an indivisible thing, nor do I think the law so regards it."

§ 210. **Land-grants subsequently made to assist in the Construction of the Road not covered.** — Such land-grants are not, as a general rule, covered, the idea of acquisition for the immediate purpose of furthering the business of a company as a carrier not being deemed to extend to this class of property, although it may, as a matter of fact, supply the only available means for enabling that business to be started.[1]

The same rule applies, of course, still more strongly in States where the authority of the company to mortgage after-acquired property is expressly limited to such as becomes a portion of the railroad. Thus it has been held under the law of Louisiana that a grant from the United States of lands entirely exterior to the right of way, and in no way promoting the business of the company except by the money received from purchasers or tenants, is not covered.[2]

A land-grant, however, may be covered by appropriate words before it has been located by the filing of the map, or even before it has been made by the government.[3]

[1] Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. (1879), 64 Ala. 603, where the mortgage was of the railroad, "and all other property now owned, and which may be hereafter owned."

[2] New Orleans & Pac. Ry. Co. *v.* Union Trust Co. (1890), 41 Fed. Rep. 717. This decision was affirmed in New Orleans Pac. Ry. Co. *v.* Parker (1892), 143 U. S. 42, where, however, the court laid more stress upon the fact of such lands not falling under the description of "appurtenances" (see § 231, below), the theory that they did so fall having been relied upon by counsel.

[3] Parker *v.* New Orleans, B. R. & V. R. Co. (1888), 33 Fed Rep. 693.

§ 211. **Lands acquired for Depots, etc., covered.** — It is well settled that lands purchased for the erection of such buildings as depots, stations, warehouses, woodyards, machine-shops, and the like are covered by the after-acquired clause.[1]

§ 212. **Lands acquired for the Right of Way are covered.** — A right of way is an easement appurtenant to the road as an entirety, which in its nature must be perpetual. Being therefore assignable, it will pass to the purchaser at the foreclosure of a mortgage of the property and franchises of the company.[2]

The right of way for the purposes of this rule is not necessarily that which was first located. The mortgage binds the road as it is actually built, such being the fair construction of the language ordinarily employed in railroad mortgages.[3]

This construction is sometimes corroborated by the language of the statute authorizing the change of route. Thus, where the right of transfer conferred contemplates the acquisition by the company of a branch road by which to connect with another railroad, and a change in this contemplated link of connection is authorized by a subsequent statute which does not declare the original right to be withdrawn or limited, there is a strong implication that the right extends to the substituted route.[4]

But in no case is the position of the land the *sole* test applied; and it has been expressly held that the fact of its being outside the right of way is not incompatible with the lands being subject to the lien, provided it has been devoted to railroad purposes, such as the erection of a depot or station.[5]

On the other hand, the fact that the tract in question is outside the right of way is of considerable importance in determining

[1] Seymour *v.* Canandaigua & Niagara Falls R. Co. (1857), 25 Barb. 284; Stevens *v.* Watson (1865), 4 Abb. Ct. App. Dec. 302.

[2] Junction R. Co. *v.* Ruggles (1857), 7 Ohio St. 1; s. p. Pollard *v.* Maddox (1856), 28 Ala. 321.

[3] Elwell *v.* Grand St. & Newtown R. Co. (1874), 67 Barb. 83; Seymour *v.* Canandaigua & Niagara Falls R. Co. (1857), 25 Barb. 284; Meyer *v.* Johnston (1879), 64 Ala. 603; s. c. 8 Am. & Eng. R. R. Cas. 584; Miller *v.* Rutland & Washington R. Co. (1863), 36 Vt. 452. In the case last cited the court said: "It may be taken as granted that, in fact, the location of the road was changed, at different points, from the place fixed upon in the original location, after the mortgage took effect, and that it has been located and constructed beyond one terminus of its location and survey, as it was at that time. Still, if it is the railroad of the corporation under its charter, the whole becomes, in our apprehension, subject to the mortgage. . . The road then [when the mortgage was executed] in the process of construction, with the rights and privileges of the company in it as a road completed, was the thing mortgaged" (citing Willink *v.* Morris Canal & Bkg. Co. (1843), 4 N. J. Eq. 377; Pennock *v.* Coe (1859), 23 How. 117; Morrill *v.* Noyes (1863), 56 Me. 458).

[4] East Boston Freight R. Co. *v.* Eastern R. Co. 1866), 13 Allen (Mass.), 422.

[5] Coe *v.* New Jersey Midland Ry. Co. (1879), 31 N. J. Eq. 105.

whether it falls into the category of land acquired for railroad purposes or not,[1] or of a building intended to serve as a boarding-house for the employees of the company and an eating-house for the passengers. The mere fact that such a building, besides being thus used in forwarding the business of the company, is also used as a house of entertainment for the public at large, does not make it an outside, independent enterprise.[2]

If the rights acquired by the company in the right of way are simply in the nature of an easement, and the track is never laid, owing to a change of route, the abandoned lay-out necessarily reverts to the owner and is not covered by the mortgage.[3]

A sale under a foreclosure of a statutory mortgage whereby everything contained therein is to pass to the purchaser will carry a right of way obtained subject to a condition of reverter in the event of a failure to complete the road.[4]

§ 213. **Terminal Facilities covered.** — Terminal facilities are covered by a mortgage expressed to be upon a "line of railroad constructed or to be constructed, together with all the stations, depot grounds, engine-houses, machine-shops, buildings, erections in any way now or hereafter appertaining unto said described line of railroad." The stations, etc., in the terminal cities appertain to the railroad as fully as similar structures in places between the termini.[5]

§ 214. **Lands held by Equitable Title covered.** — If the other conditions necessary to bring the land under the protection of the mortgage are satisfied, the fact that the legal title is outstanding in another, while the company holds only the equitable title, will not prevent the lien from attaching under words of general description.[6]

[1] Seymour *v.* Canandaigua & Niagara Falls R. Co. (1857), 25 Barb. 284; Boston & New York Air Line R. Co. *v.* Coffin (1882), 50 Conn. 150; s. c. 12 Am. & Eng. R. R. Cas. 375.

[2] Omaha & St. Louis Ry. Co. *v.* Wabash, St. Louis, & P. Ry. Co. (1891), 108 Mo. 298; s. c. 18 S. W. Rep. 1101; United States Trust Co. *v.* Wabash, St. Louis, & P. Ry. Co. (1887), 32 Fed. Rep. 480.

[3] Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467.

[4] Harrison *et ux.* *v.* Lexington & Frankfort R. Co. (1849), 9 B. Monr. (Ky.) 470.

[5] Central Trust Co. *v.* Kneeland (1891), 138 U. S. 414; s. c. 11 Sup. Ct. Rep. 357. In this case the above ruling was made on general principles, but "terminal facilities" were specified in the mortgage under discussion in the clause following that which was construed.

[6] Toledo, D. & B. R. Co. *v.* Hamilton (1890), 134 U. S. 296; s. c. 10 Sup. Ct. Rep. 546; Central Trust Co. *v.* Kneeland (1891), 138 U. S. 414; s. c. 11 Sup. Ct. Rep. 357; Wade *v.* Chicago, Springfield, & St. Louis R. Co. (1893), 149 U. S. 327; s. c. 13 Sup. Ct. Rep. 892. In the last two cases the legal title had been taken by the financial agent of the company under circumstances which raised a resulting trust in favor of the company. To the same effect is Boston & New York Air Line R. Co. *v.* Coffin (1882), 50 Conn. 150,

Such a title is acquired by a contract for the conveyance of land entered into after the execution of the mortgage.[1]

The situation is not affected by the mere fact that the contract was originally made by other parties, and assigned by them to the company.[2]

This principle, however, will not be applied in favor of the mortgagee and against an adverse claim for a lien on the property, unless the title is completed before the second lien has attached.[3]

§ 215. **Leasehold Interests, when covered.** — A leasehold interest in real property will pass, provided the words of the mortgage comprehend it, either expressly or by reasonable implication, and the contract by which it vests in the company was entered into with the purpose of forwarding its business as an agency of transportation.[4]

So also a mortgage purporting to convey, among other property, "all the corporate rights, privileges, franchises, and immunities, and all things in action, contracts, claims, and demands," of the mortgagor, whether now owned or hereafter acquired," will cover a lease of a belt railroad necessary to afford the mortgagor proper terminal facilities.[5]

A railroad company had executed a mortgage upon its line of railroad, "with the appurtenances now completed, or to be hereafter

12 Am. & Eng. R. R. Cas. 375, where the president and treasurer had purchased the lands with the funds of the company, and taken the title in their own names.

[1] Hamlin *v.* European & North American Ry. Co. (1881), 72 Me. 83; s. c. 4 Am. & Eng. R. R. Cas. 503. The court attached some importance to the fact that the right of the contractee in such a case had a *legal* existence, and was subject to levy. But this circumstance was not alone relied upon, and in any case it is plainly immaterial in considering the effect of the after-acquired clause. The whole foundation of the mortgagee's rights under that clause is of an equitable nature, and its effect is necessarily determined on equitable principles, and according to those the contractee is the owner of the land.

[2] Farmers' Loan & Trust Co. *v.* Fisher (1862), 17 Wis. 114.

[3] Toledo, D. & B. R. Co. *v.* Hamilton (1890), 134 U. S. 296; s. c. 10 Sup. Ct. Rep. 546, commenting on Williamson *v.* New Jersey Southern R. Co. (1877), 28 N. J. Eq. 277; s. c. 29 N. J. Eq. 311 (1878), and Botsford *v.* New Haven, Middletown, & Willimantic R. Co. (1874), 41 Conn. 454, where the mortgage was postponed on the ground that the second lien had attached when the full equitable title rested in the mortgagor.

[4] Barnard *v.* Norwich & Worcester R. Co. (1876), 14 N. B. R. 469; s. c. 4 Cliff. 348. In this case "leases" were specifically mentioned, but the court (per Clifford, J.) rested its decision also on the ground that a lease was covered by a mortgage of "all the estate, real, personal, and mixed," of any of the descriptions named. In Beekman *v.* Hudson River West Shore Ry. Co. (1888), 35 Fed. Rep. 3, the lease was assumed to be valid, the only argument being as to whether the transfer was valid.

[5] Columbia Finance & Trust Co. *v.* Kentucky Union Ry. Co. (1894), 60 Fed. Rep. 794.

constructed, together with all the lands, tenements, hereditaments, fixtures, buildings, cars, engines, tools, and machinery, franchises, privileges, interest, and estate of the first party appertaining thereto, which the party of the first part now possesses or owns, or may hereafter acquire," in trust to secure an issue of bonds. Subsequently the mortgagor leased its road and property for ninety-nine years to another company. By the terms of the lease the lessee company covenanted in a certain event to advance money to pay accruing coupons for interest on the bonds of the lessor when due. This lease was, in a State court, cancelled in an action brought by stockholders of the lessee company. Upon default in payment of the interest coupons of the bonds the trustees of the bondholders, before a federal court, in an action for foreclosure of their mortgage, sought to have their decree cover this lease, and have the covenants of the lease as to the lessee's making advances to pay interest on their bonds enforced against the lessee company, contending that their mortgage covered the rights of the mortgagor company against the lessee under the lease. The holding of the court was adverse to this contention, and the trustees were allowed a decree of foreclosure against the property of the lessor company only.[1]

[1] Moran *v.* Pittsburg, C. & St. L. Ry. Co. *et al.* (1887), 32 Fed. Rep. 878. The court said : " That said lease having been executed *subsequent* to the mortgage, no *privity of estate or contract was thereby created* between the mortgagee and lessee. It is the well-settled rule in this country and in England that, inasmuch as *no reversion* vests in the mortgagee under such circumstances, he cannot distrain or bring an action, either at law or in equity, for the rents payable by the tenant, nor is he entitled to enforce the covenants and provisions of the lease. He has no election, either before or after the mortgagor's default, to adopt and demand the benefits of the lease without the consent of the lessee. His remedy is to foreclose upon default of the mortgagor, or to take possession of the premises and thereby place himself in position to obtain the future profits. Either step operates as an eviction of the tenant by title paramount, and leaves him at liberty to terminate the lease and quit," citing many cases. Further on it was said: "The lease in question does not come within the description of the property, rights, or franchise covered by the mortgage, nor is it in any sense 'after-acquired property' within the meaning of these terms as used in said mortgage. Even if the income, rents, and profits of the road had been covered by the mortgage, the personal covenant of the lessee to make 'advances,' as provided in the lease, could not be treated as 'income' of the road, or as part of the 'purchase' of the mortgage. The subject of 'after-acquired property,' under mortgages containing similar provisions and clauses as the present, has often been before the Supreme Court, but no case yet decided has gone to the extent of holding that personal contracts or covenants entered into with the mortgagor, and under which no new estate is acquired by the mortgagor, come within these terms;" citing cases.

ARTICLE VI. — WHAT IS A SUFFICIENT DESCRIPTION TO PASS AFTER-ACQUIRED PERSONALTY.

§ 216. **General Principles.** — The rule that a specific description of the property intended to be conveyed is necessary, unless it is acquired for railroad purposes, is equally applicable to personalty. As to certain kinds of personalty there is no difficulty in pronouncing that they do or do not belong to the class which calls for such a description. But some articles lie near the border line, and a thoroughly consistent rule cannot be extracted from the authorities, while the uncertainty inherent in the subject is increased both by the varying phraseology employed in the mortgages, and by the fact that some courts have deemed it necessary to consider not merely the nature of the article and the purposes of its acquisition, but also whether, supposing it to have been acquired for railroad purposes, the application to such purposes has actually begun or not. The doctrine of these courts is that, unless the property is already in use upon the road, it is not protected by the mortgage.

§ 217. **Materials for the Track and for the Operation of the Road generally.** — The uncertainty arising from the cause just referred to is well exemplified in the case of personalty, about which it would *prima facie* have been supposed that there could have been no doubt whatever, provided the mortgage contained any term covering personalty as a whole. If the destination of the articles is the true criterion, there seems to be no valid reason for excluding from the protection of the lien chattels acquired with a view of constructing or repairing the track, replacing the worn-out parts of rolling-stock, and supplying the locomotives and machine-shops with fuel. The preponderance of authority is in favor of the doctrine that such personalty is covered as soon as the company becomes its owner, and without regard to the fact that, at the time when an adverse claim to it is asserted, it has not been put into actual use. In fact no other rule could be enforced, consistently with the continued operation of the road; for if the lien were not effectual to this extent, the general creditors might, by constantly intercepting the necessary supplies, soon reduce the railroad to a helpless condition. Accordingly it has been held that cars, wheels, firewood obtained for the use of the engines, and coal for the use of the machine-shop are covered, on the broad ground that they are things incident and indispensable to the use and enjoyment of the thing conveyed.[1]

[1] Phillips *v.* Winslow (1857), 18 B. Monr. (Ky.) 431.

So also a clause covering personal property "now owned or hereafter to be acquired" embraces old or new rails along the track in readiness for repairs.[1]

So also rails, fish-plates, and bolts, purchased by the company for the use of its road, but not yet actually used, and stacked on land not within the right of way, are covered by a mortgage which includes all real and personal property of every kind and description "used or intended to be used in connection with or for the purpose of the railroad."[2]

A fortiori will the same rule prevail as between the bondholders and the company.[3]

In an early Wisconsin case,[4] on the other hand, it was held that certain railroad chairs, never used in the construction of the track, were not covered by the conveyance of a "railroad, with all the superstructure, track, and all other appurtenances, made or to be made, also all and singular the furniture, including the engines, etc., *materials*, machinery, and every other kind of personal property which shall be *used in operating said railroad.*" The ruling was based upon the ground that the rails, under these circumstances, could not be brought under the description of "appurtenances," nor could they be said to be "used in operating the road."

This decision is certainly opposed to the earlier and later authorities cited above. The consideration that the rule stated in this last case would, if accepted, place the company in the position of carrying on its business by the mere sufferance of its general creditors, is an unanswerable objection to it if the interests of the community are to be taken into account. "If," as was pertinently observed by Mr. Justice Agnew, in a case decided in the Pennsylvania Court of Common Pleas, "besides the rails and their supporting chairs actually embedded in the track, the company may not maintain deposits of others, at convenient intervals, for immediate repair, and, if because they thus lie in piles, they may be seized all along the route by successive writs, the usefulness of the railway as a public work must cease. If it may

[1] Covey *v.* Pittsburg, Fort Wayne, & Chicago R. Co. (1858), 3 Phil. 173.

[2] Farmers' Loan & Trust Co. *v.* San Diego Car Co. (1891), 45 Fed. Rep. 518.

[3] Weetjen *v.* St. Paul & Pac. R. Co. (1875), 4 Hun, 529. Here the property, iron rails, was held to be covered by a mortgage covering "any and all rolling-stock, equipment, and materials whatsoever," acquired or furnished for the use of said railroad. See Hunt *v.* Bay State Iron Co., 97 Mass. 279, as to rails attached to realty remaining chattels of vendor, by agreement between vendors and railway company.

[4] Farmers' Loan & Trust Co. *v.* Commercial Bank of Racine (1860), 11 Wis. 207; s. c. 15 Wis. 424 (1862).

be dismantled by attacking it in detail and seizing those things most easily removed, though essential to its preservation, it would be but a step to the end; when stripped of all but its road-bed and fixtures, it would be powerless to serve the public or benefit itself." [1]

On the other hand it would be a very strained construction of the words of such a mortgage to assume that the intention of the parties is merely to protect the articles while in actual use. Such a construction, in fact, would give the after-acquired clauses no greater protective effect than that of the common-law rule which declares that personalty is not liable to seizure while it is being actually applied to the discharge of the duties connected with that franchise. This can scarcely be the meaning of the words, interpreted, as they should be, not according to narrow technical rules, but with a constant reference to the interests of the public.

Apart from these objections there is high authority for the doctrine that the articles denied by the Wisconsin court to be subject to the mortgage in question are a part of the realty and pass as fixtures, independently of whether the description is worded so as to include them or not.[2]

§ 218. **Rolling-stock, when covered.** — Rolling-stock will pass under a mortgage of "all the present and future to be acquired property of the company, including the right of way and land occupied, and all rails and other materials used thereon or procured therefor," — the reason assigned being that the specific pledge of a thing carries other things without which it would be of no use.[3]

On the analogous principle that, when a thing is granted, all the means to attain it, and all the fruits and effects of it, are granted, a mortgage of the entire line of the railroad, with all the tolls and revenues, covers not only the line of the road, but all the rolling-stock and fixtures, whether movable or immovable, essential to the production of tolls and revenue.[4]

A like effect has been given to a mortgage of "all the road, property, rights, liberties, privileges, corporate franchises, incomes, tolls, and receipts, then held or thereafter to be acquired," as far

[1] Covey v. Pittsburg, Fort Wayne, & Chicago R. Co. (1858), 3 Phil. 173.

[2] Palmer v. Forbes (1860), 23 Ill. 301. See §§ 227 *et seq.*, *post.*

[3] Pullan v. Cincinnati & Chicago Air Line R. Co. (1865), 4 Biss. 35. Rolling-stock is now usually acquired through what are known as car-trust contracts. These are discussed in another part of the work (Chap. XIV.).

[4] State v. Northern Central Ry. Co. (1861), 18 Md. 193.

as regards rolling-stock in actual use and required for the transaction of its business.[1]

It seems, however, that some word signifying an intent to pass the personal property of the company is necessary to constitute a description sufficient to cover rolling-stock, unless, of course, where the doctrine obtains that it is a fixture. Thus a mortgage of the "road and its franchises" will not be construed as embracing the rolling-stock, or any of the furniture or equipment of the road which is not so connected with the realty as to partake of its character.[2]

Where a railroad consists of two or more divisions, and a mortgage is given at different times on each division, and then upon the whole line, each mortgage being worded so as to cover "all and singular the locomotive engines and other rolling-stock, and all other equipments of every kind and description which have already been or may hereafter be procured for or used on said road," and expressly made subject to prior mortgages of the road, and the rolling-stock is purchased with the general funds of the company, and used upon the whole line without any apportionment between the several divisions, the mortgages will, as regards the entire rolling-stock, take rank according to their dates, and the earliest divisional mortgage will have a priority over the other divisional mortgages as well as over the mortgage of the entire line. This inference in regard to the rolling-stock will, however, be rebutted by words which show the intention of the parties to make the several mortgages distinct as to everything else conveyed by them.[3]

Where a mortgage of a division contains a covenant to designate in a certain mode, as belonging to that division, such a proportion of the whole rolling-stock owned by the mortgagor, as that division bears to the entire railway, only such rolling-stock as is thereafter designated is covered, although it is less in amount than the amount which by the covenant is to be so designated.[4]

A chattel mortgage covering the property of a street-railway company, including its after-acquired property, has been held not to cover rolling-stock and other equipments purchased by

[1] Philadelphia, Wilm. & Balt. R. Co. *v.* Woelpper (1870), 64 Pa. St. 366.

[2] Miller *v.* Rutland & Washington R. Co. (1863), 36 Vt. 452.

[3] Minnesota Co. *v.* St. Paul Co. (1864), 2 Wall. 609.

[4] United States Trust Co. *v.* Wabash W. Ry. Co. (1889), 38 Fed. Rep. 891. In the opinion of Mr. Justice Miller in Minnesota Co. *v.* St. Paul Co., *supra*, he refers to the competency of a railroad company to designate and assign a certain portion of its rolling-stock to one division of its road and another portion to another as a conceded matter.

a company which had before purchased the franchises and property of the mortgagor company, to be used in conducting the business over the whole line of road.[1]

§ 219. **Office Furniture, when covered.**— Office furniture, suitable in kind and of a necessary amount, provided for the use of the employees in the performance of their daily duties, as well as for the directors to transact their business, are covered by a general "after-acquired property" clause.[2]

§ 220. **Fuel, when covered.** — In City of Bath *v.* Miller[3] the court declined to express an opinion as to whether the "after-acquired property" clause embraced wood used for fuel; but, under the given circumstances it was held to be attachable.

§ 221. **Personalty not used for Railroad Purposes.** — The converse of the rule illustrated by the preceding sections has often been applied. Thus the general clause as to after-acquired personal property will not cover canal-boats, purchased with the funds of the corporation, and used in connection with the railroad, but beyond its terminus;[4] and still less will it embrace property bought of an opposition steamship line, not with a view of employing it in connection with the business of the road, but in order to put a stop to its competition.[5]

[1] Hinchmau *v.* Point Defiance Ry. Co. *et al.* (Boyle *et al.*, Interveners) (Wash., 1896), 44 Pac. Rep. 867.

[2] Ludlow *v.* Hurd (1857), 1 Dis. 552. Compare Buck *v.* Seymour (1878), 46 Conn. 156. It will be shown hereafter that such property is not covered as a *fixture.*

[3] 51 Me. 341 (1863); s. c. 53 Me. 308 (1865). The mortgages to be construed were executed in pursuance of a statute authorizing the company to execute to the Treasurer of the City of Bath a mortgage of a certain extension of their railroad, . . . and of *all the property of said extension* which they then had or might subsequently acquire, "the said mortgage to be made" so as to embrace not only the said extension, but also the *original road of said company,* and all the property of said road. The court pointed out that this statute treated the "extension" and the "original road" as separate and distinct corporations, and that the wood in controversy, not having been bought with the special funds of either portion, did not belong to either. Being bought with the funds of the "whole of said railroad," it belonged to and was "the property of the whole of said railroad."

The "after-acquired" clause, therefore, could have no application, since it was only in reference to the "extension" that this term was employed.

That fuel will not pass under the mortgage as a *fixture,* see § 220, *post.*

For a case holding that a mortgage of the "franchises" of a railroad company will cover "fuel," see Dunham *v.* Earl *et al.* (1859), 8 Fed. Cas. 41, Case No. 4149.

[4] Parish *v.* Wheeler (1860), 22 N. Y. 494. This case turned partly on the meaning of the word "appurtenances" (see §§ 231, 232). With this case may be contrasted Williamson *v.* New Jersey Southern R. Co. (1874), 25 N. J. Eq. 13, where a mortgage covering after-acquired personalty in general terms, and specifically enumerating as a part of such personalty "steamboats," etc., to be used in connection with the business of the road, was allowed to take effect.

[5] Morgan & Raynor *v.* Donovan (1877), 58 Ala. 241; s. c. 21 Am. Ry. Rep. 109. In this case there was also a lack of authority to make the purchase.

Nor does a mortgage on all other "personal property belonging to said company as the same is now in use by said company, or as the same may be hereafter changed or renewed by said company," embrace certain machinery for burnetizing ties and timber to render them more durable, the machinery not having been in existence at the time of the execution of the mortgage, nor substituted for anything that was therein specified, but merely constructed by the railroad company as a mere experiment.[1]

§ 222. **Choses in Action and Stock, when covered.** — *Choses in action* are not, as a general rule, covered. Thus the phrase "chartered rights, privileges, and franchises" does not embrace the unpaid balance of a subscription to the stock of the company.[2] Nor will a mortgage in the usual form, covering personalty, carry the interest of the mortgagor in a contract with the United States government for carrying the mails;[3] nor municipal subscriptions to aid in the construction of the road;[4] nor an appropriation by a county for that purpose, at least until the claim of the company is capable of being enforced against the county;[5] nor notes given by a real-estate company with a mortgage upon the property, as security to the company, in consideration of its agreement to extend its line through or to the mortgagor's property.[6]

A deed of trust made by a coal and railway company embracing all the "personal property of every kind now owned, or hereafter to be acquired and owned and used, whether by purchase or otherwise, in connection with, and for use in developing and operating, its said coal mines or other works of improvement now on or hereafter to be opened upon said lands or any part thereof," was construed by the Alabama Supreme Court. The court said: "This clause manifestly refers not to the product or income from said mines, but to chattels used in carrying on the mining operations, and in operating in connection therewith the railway covered by the instruments, such as engines, cars, live-stock, mining implements, and the like."[7]

[1] Brainerd *v.* Peck (1861), 34 Vt. 496.

[2] Dean *v.* Biggs (1881), 25 Hun, 122. Compare Morris *v.* Cheney (1869), 51 Ill. 451.

[3] St. Paul & Duluth R. Co. *v.* United States (1885), 112 U. S. 733; s. c. 5 Sup. Ct. Rep. 366. In Farmers' Loan & Trust Co. *v.* Cary (1860), 13 Wis. 110, a like ruling was made on the ground that there were no apt terms to cover the income.

[4] Morgan County *v.* Thomas (1875), 76 Ill. 120; Smith *v.* McCullough (1881), 104 U. S. 25.

[5] Board of Commrs. *v.* The State (1888), 115 Ind. 64.

[6] Farmers' Loan & Trust Co. *v.* San Diego Street Car Co. (1891), 45 Fed. Rep. 518.

[7] Alabama Nat. Bank *v.* Mary Lee Coal & Railway Co. (Ala., 1896), 19 So. Rep. 404, in which a bill was filed by

The capital stock of another company, acquired by lawful authority with a view to consolidation with that company, is covered by a mortgage embracing after-acquired personalty.[1]

§ 223. **Permanent and Temporary Disuse, Effect of.** — After the lien has once attached, it is not displaced by the permanent disuse of the mortgaged articles. Thus personalty cast off because worn out, and fragments and old materials, have been held to continue under the mortgage, if a proper and judicious management of the road requires that they shall be recast or exchanged for new articles for the use of the road.[2]

The limitation here implied is perhaps unnecessary. At all events, it has been held in another State that where the mortgage expressly covered "rails," the mortgagees had a right to insist that the money received from the sale of old rails shall be applied to keep down the interest on the bonds,[3] — a ruling which seems to assume the existence of a general principle, that the lien attaches to anything which may take the place of the article mortgaged, whether the substituted article be another manufactured from the old materials, or another of the same kind purchased with the proceeds, or the proceeds themselves. Nor, indeed, does there seem to be any valid reason why the doctrine should not be carried further, so as to give the mortgagees a prior claim to property acquired with the proceeds, although that property is not of a kind which would be covered by an ordinary after-acquired clause, apart from such a consideration. Such an extension of the doctrine would obviously be quite in harmony with the equitable rule which denies the possibility of divesting an equitable lien by any change in the form of the property, so long as the rights of *bona fide* purchasers without notice have not intervened.

general creditors to withdraw from the possession of the receiver in foreclosure proceedings certain coal which had been mined, certain coke and pig-iron which had been manufactured and was in the possession of the company before the receivership, as well as certain bills receivable which the company had representing the proceeds of sales of such manufactured articles, or to have them administered for the benefit of the general creditors, the receiver having, when appointed, taken possession of them for the benefit of the bondholders.

[1] Williamson *v.* New Jersey Southern R. Co. (1875), 26 N. J. Eq. 398.

[2] Cooper *v.* Wolf (1864), 15 Ohio St. 523. In this case the subject-matter of the lien was the "engines, cars, tools, materials, machinery, contracts, and all other personal property, right, or interest therein." Two judges dissented from the decision on the special ground that the mortgagor had reserved a right to control the property in question, and that it was therefore liable to execution.

[3] First National Bank of Salem *v.* Anderson (1881), 75 Va. 250; s. c. 12 Am. & Eng. R. R. Cas. 411.

The mortgage also continues in effect although the articles temporarily cease to form a part of the property employed in the operation of the road.[1]

§ 224. **Alterations in the Subject-matter of the Pledge.** — If an essential alteration is made in one part of the equipment of a railroad, the necessary alterations in the rest of the equipment may be made for the purpose of adapting it to the new conditions, without divesting the lien.[2]

A fortiori must the lien continue where the changes simply create a difficulty in identifying the property. Thus, where rolling-stock is purchased for a certain division of the road, and designated accordingly, the subsequent obliteration of the designation will not deprive the bondholders of their security, if the property be otherwise traceable.[3]

§ 225. **Property bought to replace that worn out, embraced by the Mortgage.** — The terms of an ordinary after-acquired clause necessarily embrace articles such as cars bought to replace those worn out, not on the ground of the substitution, but on the ground that the new articles are themselves in the category of those which it is the intention to cover.[4]

The effect of a clause which would ordinarily receive this construction is not limited by the fact that a special reference is also made to cars which may afterwards be acquired with the proceeds of the bonds issued on the security of the mortgage. This addition will be deemed to have been inserted merely to obviate any possible doubt as to whether such cars are intended to be covered.[5]

The same result must, of course, follow if the articles are held to be subject to the lien on the ground that they are fixtures.[6]

In Tennessee the courts have gone still further, and held, in the case of a lien declared in favor of the State, that it extends to property acquired to replace that worn out, although the articles are not fixtures, and there is no specific reference to subsequent acquisitions.[7]

[1] Hamlin *v.* Jerrard (1881), 72 Me. 62; s. c. 4 Am. & Eng. R. R. Cas. 62. Here rolling-stock was laid up pending a change in the gauge.

[2] Hamlin *v.* Jerrard (1881), 72 Me. 62; 4 Am. & Eng. R. R. Cas. 62. Here the cars were altered to suit a change of gauge.

[3] United States Trust Co. *v.* Wabash W. R. Co. (1889), 38 Fed. Rep. 891.

[4] Shaw *v.* Bill (1877), 95 U. S. 10.

[5] Ibid.

[6] Palmer *v.* Forbes (1860), 23 Ill. 301.

[7] McGraw *v.* Memphis & Ohio R. Co. (1868), 5 Coldw. (Tenn.) 434. Some comments have been made above on this decision (§ 208). It seems to be only sustainable on the principle that the State, and not a private party, was the mortgagee.

Replacements of rolling-stock while the road is in the hands of the receiver become, in like manner, a part of the mortgaged property, and pass to the purchaser at the foreclosure sale.[1]

§ 226. **Income, Revenues, etc.** — Income, if specifically mentioned, as where "tolls, income," etc., are referred to among the various kinds of property intended to be embraced, will, of course, be subject to the lien.[2]

In such a case the agreement of the parties is that, as soon as the income is received, it shall be held in equity for the fulfilment of the obligation of the mortgagor, and persons who, with notice of the contract, take possession of the road by virtue of a decree and sale have no claim on the money.[3]

The income pledged by such a clause is understood to be the "net income" remaining after payment of all expenses, including the money applied to the payment of interest, and laid by to form a sinking fund for the eventual liquidation of the bonds.[4]

If one railroad company mortgages to another the "net earnings" which may accrue to it, by reason of business "from and over" the line of the latter, the earnings include those arising from business carried on in both directions, whether going or coming.[5]

Income has also been held to be covered by the comprehensive term "personal property."[6]

If the mortgage contains no reference to future acquisitions of personal property, the earnings are not covered; and this rule has been adhered to even in the case of a statutory mortgage which was held to cover after-acquired personal property, although not specifically mentioned, provided it is such as is to be used for railroad purposes.[7]

1 Strang *v.* Montgomery & Eufaula R. Co. (1879), 3 Woods, 613.

2 Galena & Chicago Union R. Co. *v.* Menzies (1861), 26 Ill. 121; Jesup *v.* Bridge (1861), 11 Iowa, 572. It should be noticed that these cases were decided at a date when the *power* to mortgage after-acquired property was still to some extent disputed. The discussion in the opinions deals rather with this aspect of the case than whether, *as a matter of construction*, the mortgage covered the income. In later cases most of the litigation in which the effect of the mortgage upon the income has been considered have related neither to the powers of the company nor to the construction of the instrument, but to the priorities as between the mortgagees and creditors whose claims are based upon some alleged superior equity. (See Chap. XXVIII., preferred debts.) See 86 Tex. 627; 79 Fed. Rep. 215.

3 Pullan *v.* Cincinnati & Chicago Air Line R. Co. (1873), 5 Biss. 237.

4 Parkhurst *v.* Northern Central R. Co. (1863), 19 Md. 472.

5 Schmidt *v.* Louisville, etc. Ry. Co. (Ky., 1894), 25 S. W. Rep. 49.

6 Kelly *v.* Trustees (1877), 58 Ala. 489; s. c. 21 Am. Ry. Rep. 138.

7 McGraw *v.* Memphis & Ohio R. Co. (1860), 5 Cold. (Tenn.) 434.

Nor will a mortgage of the "franchises, pledges, and rights of the company in and to" the road, etc., pass the income.[1]

The trustee's rights to the earnings is independent of its *situs*, and does not require the striking of a balance in order to ascertain the net profits. Hence, where a mortgage covering income was made on an Arkansas railroad extending into Tennessee, the lien protects against attachment moneys derived from this source, found in Tennessee in the hands of the treasurer of the company.[2]

Article VII. — Necessity for a Specific Description qualified by the Doctrine of Fixtures.

§ 227. **General Rule. — Things which are absolutely Fixtures.** — It is common learning that a mortgage of real property will, as a general rule, carry, as a part of the security, all fixtures belonging to the realty, without any special mention of them being made in the mortgage. A railroad corporation, therefore, when it mortgages its road, tracks, and franchises, thereby mortgages all its permanent fixtures, such as the road equipments for its continued use; and by such a mortgage all future additions to it of the same permanent nature, being an incident to the real estate, must become subject to the lien in the same manner as improvements to the real estate mortgaged by individuals.[3]

The practical application of this rule involves no difficulty up to a certain point. There is no controversy as to the principle that personalty which is worked up into bridges, depots, and other structures become invested with the character of real property, and will therefore pass under a mortgage of the road, although not referred to in terms, and although erected after the making of the mortgage.[4]

A mining ditch or flume is in the nature of real estate, and a mortgage thereon will, without any special provision, include all improvements or fixtures then on the line located for the work, as well as those which may thereafter be put thereon.[5]

§ 228. **Detached Personal Property.** — Detached personal property, on the other hand, such as fuel, office furniture, material

[1] Farmers' Loan & Trust Co. *v.* Cary (1860), 13 Wis. 110, referring to Farmers' Loan & Trust Co. *v.* Commercial Bank (1860), 11 Wis. 207; Dinsmore *v.* Racine R. Co. (1861), 12 Wis. 649. See Alabama Nat. Bank *v.* Mary Lee Coal & Ry. Co. (Ala., 1896), 19 So. Rep. 404.

[2] Buck *v.* Memphis & Little Rock R. Co. (Tenn. Sup. Ct., 1877), 4 Cent. L. J. 430.

[3] Hunt *v.* Bullock (1860), 23 Ill. 320.

[4] McGraw *v.* Memphis & Ohio R. Co. (1868), 5 Coldw. (Tenn.) 434.

[5] Union Water Co. *v.* Murphy's Flat Fluming Co. (1863), 22 Cal. 620.

for lights, which are not designed, like road equipments, for the continued use of the road, are held to be chattels which can only be subjected to a mortgage lien by an instrument specifically mentioning them, and executed in conformity with the laws relating to chattel mortgages.[1]

Such articles are merely intended for consumption, and may be sold and carried away, and used for other purposes, as well as the operation of the road. Nor have they any distinguishing mark to show that they are designed for purely railroad purposes.[2]

An iron safe has been held to be property of this description, on the ground that it has "none of the distinctive features or essential qualities that belong to real estate."[3]

Whether rolling-stock is a fixture is a question upon which the courts are divided. The authorities are reviewed in another chapter. (See Chapter XIV., on Car Trusts.)

A planing-mill, unless it is so attached to the realty as to indicate that it is designed to be permanent, or its removal would be injurious to the freehold, is personal property.[4]

Article VIII. — Necessity for a Specific Description qualified by the Doctrine that a Railroad is an Entirety.

§ 229. **The Doctrine of Accession.** — The doctrine of accession, of which the rules relating to fixtures are the most familiar illustration, has been extended by some courts to cover a much wider class of cases than those referred to in the preceding subdivision of this chapter. The theory that a railroad and its franchises constitute an entire indivisible thing, and that for this reason a mortgage of the road will pass after-acquired property, even though not specifically mentioned or described in the instrument, was first propounded in Pierce *v.* Emery.[5] There the trustees

[1] Hunt *v.* Bullock (1860), 23 Ill. 320; Gregg *v.* Sanford (1860), 24 Ill. 17; Farmers' Loan & Trust Co. *v.* St. Jo. & Denver City Ry. Co. (1875), 3 Dill. 412.

[2] Palmer *v.* Forbes (1860), 23 Ill. 301. The intention to make articles of this sort fixtures is clearly absent, as well as the requisite physical connection with the realty. As was observed by Caton, C. J., in the case just cited: "To say that a mortgage which upon its face provides for its maturity twenty years hence was designed to embrace and hold the fuel and oil which all knew and intended should be consumed to-morrow, is, if not absurd, a refinement beyond that practical common sense we are capable of understanding."

[3] Titus *v.* Mabee (1861), 25 Ill. 257. It is presumed, however, that this ruling was intended to apply to a detached safe. Such an article, it is submitted, is to be classed with those which may or may not be fixtures, according to the nature of their connection with the realty and the intention of the parties.

[4] Titus *v.* Mabee (1861), 25 Ill. 257.

[5] 32 N. H. 484 (1856).

were empowered by the statute authorizing the execution of a trust mortgage on the railroad to sell the property upon the non-payment of the principal or interest of the bonds, and the conveyance executed to the purchasers was to have the effect of transferring to them "all the real and personal estate named in the mortgage deed, together with all the rights, *franchises, powers, and privileges* in relation to the same which the corporation enjoyed, or possessed, or were entitled to at the time of the execution of the mortgage deed." A mortgage executed in pursuance of the provisions of this statute was alleged to cover a quantity of railroad iron afterwards purchased for the use of the road, and therefore not specifically mentioned in the mortgage. This view prevailed, the position taken being that the right to acquire property was one of the franchises of the company, so that a transfer of the franchises necessarily involved a transfer of the property which might subsequently be acquired by the exercise of that franchise. In the opinion much stress is laid on the special circumstances of the case, and the apparent intention of the legislature in conferring the power specified in the charter. For this reason a doubt has been expressed whether the decision is, properly speaking, an authority for the general principle which it is thought to have laid down.

This doubt, however, has not been shared by other courts, and upon a review of the argument we think it can scarcely be disputed that the decision was really intended to rest on the doctrine of accession, although the fact that the conclusion thus arrived at was apparently the one best calculated to give effect to the presumed intent of the legislature was not without its influence. A similar doctrine was applied soon afterwards in Kentucky, the court holding that a pledge of the road itself, with its profits and privileges, and the rights and franchises of the corporation, covered all such future acquisitions as were necessary and proper for the full and complete use of the road.[1]

The court reasoned as follows: "Now it is evident that as the pledge was to continue during many years, and new cars and engines and materials of different description would from time to time become necessary, and fuel would all the time have to be purchased as it was needed, these articles were therefore included in the deed; and as the business of this road could not be carried on without them, the power to pledge the road itself with its

[1] Philips *v.* Winslow (1857), 18 B. Mon. (Ky.), 431. This conclusion was arrived at independently, so far as can be ascertained from the report, Pierce *v.* Emery not being referred to.

profits and privileges, and the rights and franchises of the corporation, carried along with it the implied authority to pledge all such future acquisitions of the company as were necessary and proper to the full and complete use and operation of the road itself."

In the same year the Supreme Court of New York lent its sanction to the same theory, though the property in question (the right of way) was also held to be subject to the lien by virtue of the rule enforced in Pennock *v.* Coe.[1]

§ 230. **Objections to this Extension of the Doctrine of Accession.** — The doctrine announced in these early cases, though sometimes mentioned with respect in recent decisions,[2] seems to rest on very dubious foundations, and it has frequently been attacked. That it is not in harmony with the general principles of law relating to the effect of a mortgage upon subsequent acquisitions is not denied, and no satisfactory reason has been given for applying different rules in a case of this kind to mortgages by individuals and mortgages by railroad companies. A specially serious objection to the principle formulated in Pierce *v.* Emery is that, if it is tested by carrying it to its logical conclusion, it will have the effect of attaching the lien of a railroad mortgage not merely to property acquired for railroad purposes, but also to property which has no connection with the business of the company as a carrier. The difficulty which must necessarily arise in accommodating such a rule to the practical working of the registration laws is self-evident. This consideration was forcibly presented in Dinsmore *v.* Racine, etc. R. Co., decided about four years after the New Hampshire case. There Judge Cole, in combating the theory that a railroad with its franchises and property is an indivisible thing, used the following language: —

"I can understand how a railroad corporation, with its franchises, may be said to be an entire, indivisible thing, — a unity. But I cannot well conceive how a railroad, with all its property, real and personal, of every nature and character, can with accuracy

[1] Seymour *v.* Canandaigua R. Co. (1857), 25 Barb. 284. One of the cases cited to sustain this theory was Willink *v.* Morris Canal & Bkg. Co. (1843), 4 N. J. Eq. 377. But an examination of that case shows that no general principle of the kind ascribed to it is laid down by the chancellor. The decision was based entirely upon a construction of the statute empowering the company to mortgage its property, and the lien was fastened on an extension of the canal, because that was deemed to be the intention of the legislature. It is also apparent from the arguments of counsel that the principle of estoppel was, to some extent at least, relied upon, — a circumstance which seems to indicate that the case should be classed rather with Pennock *v.* Coe than with Pierce *v.* Emery.

[2] Parker *v.* New Orleans, B. R. & V. R. Co. (1888), 33 Fed. Rep. 693.

be said to be an indivisible thing, nor do I think the law so regards it. If this doctrine be sound, consider one of the consequences in this case. Does it not work a revolution in our registry laws? At the time the mortgage was given to the Farmers' Loan & Trust Company upon the eastern division of the road, there was no statute authorizing a railroad company to mortgage its franchises, in force in this State. Neither was there any law giving to a mortgage made by a railroad company greater effect than was given to a mortgage by a natural person. If the mortgage of the Farmers' Loan & Trust Company became a prior lien upon the timber lands mentioned in this case, by virtue of the doctrine of entirety, there could be no safety in depending upon the record; for a person going to buy these lands of the railroad company would find nothing upon the record to apprise him that they had been mortgaged to that company. If he looked into that mortgage, he would find nothing in the description of the mortgaged premises which related to them. Finding the title of record in the railroad company unincumbered so far as he could see, he might buy or take a mortgage upon the lands, trusting to the registry law. Thinking that the same legal consequences attached to a mortgage given by a railroad company as would attach to one given by a natural person, he would find that the record was but a reference to railroads and railroad property, — such a person could only complain of his ignorance and folly."[1]

It is clear that the doctrine, even if correct, cannot be applied to a case where several mortgages are given on different divisions of the road.[2]

The only way of escaping from this difficulty is to draw a line between property used for railroad purposes and property not so used, and to declare the doctrine to be applicable to the former and not to the latter. It may readily be admitted that there would be no greater hardship in imputing notice of the lien to this extent to persons who deal with the company, where the description covers merely the road and its franchises in general terms, than in imputing such notice to those persons where the description employs such vague words as "personalty" or the like. But it will scarcely be maintained that a doctrine which has to be limited in this arbitrary manner to adopt it to the policy of the registration laws is at all satisfactory. Once such a limitation is admitted, the doctrine allows no wider scope to the lien

[1] Dinsmore *v.* Rac., etc. R. Co. (1860), 12 Wis. 649, 657.

[2] Farmers' Loan & Trust Co. *v.* Commercial Bank (1860), 11 Wis. 207.

than the principle of Pennock *v.* Coe; and as the latter is applicable to all mortgages, it seems better to give it the preference, and to discard a theory which is fraught with so many embarrassing results in practice, and which, when thus restricted to its only allowable function, is shown to be quite unnecessary and superfluous as a part of the law of mortgages. The doctrine has also been repudiated in Alabama.[1]

ARTICLE IX. — WHAT WILL PASS UNDER THE WORD "APPURTENANCES."

§ 231. **What Real Property will pass under the Term "Appurtenances."** — In construing railroad mortgages the courts have repudiated the narrow, technical meaning of the word "appurtenances." Such a meaning is deemed to be unsuited to a complex organization like a railroad, and the principle to be deduced from the cases is that, whatever property is required for the purpose of facilitating the performance by the company of its functions as a carrier will pass under this term if such appears to be the intent of the parties. This more liberal doctrine has been discussed and its precise limits defined in two recent cases decided by the Supreme Court of the United States. In New Orleans Pacific Ry. Co. *v.* Parker[2] the question was whether a mortgage by a company of its "railroad, rights of way, road-bed, and all its real estate then owned, or which might be thereafter acquired, *appurtenant to or necessary for the operation of the railroad*, and all other property, wherever situated in the State, then owned or which might thereafter be acquired by the company, and which should be *appurtenant to or necessary for the operation of the railroad*, and also the tenements, hereditaments, and *appurtenances* there-

[1] Meyer *v.* Johnston (1877), 53 Ala. 237; Morgan & Raynor *v.* Donovan (1879), 58 Ala. 241; s. c. 21 Am. Ry. Rep. 109. As to what a mortgage covers or does not cover, see Corp. of Lanark & Renfrew *v.* Cameron, 9 Up. Can. C. P. 109; Wyatt *v.* L. & K. Ry. Co., 6 Que. L. R. 213; Wickham *v.* N. B. & C. A. Ry. Co., L. R. 1 P. C. 64; Manhattan Trust Co. *v.* Sioux City Cable Ry. Co. (1896), 76 Fed. Rep. 658; Andrews *v.* Nat. Foundry & Pipe Works (Lim.), (1896), 76 Fed. Rep. 166; Platt *v.* New York & L. B. Ry. Co. (1896), 41 N. Y. Supp. 42; Col., H. & G. R. Co. *v.* Braden, 110 Ind. 558; Hovelman *v.* Kan. City Horse Ry. Co., 79 Mo. 632; Spoon *v.* C. & W. M. R. Co., 86 Mich. 309; Watt *v.* H. M. & F. R. Co., 1 Brewst. (Pa.) 418; Hazard *v.* Vermont & Can. R. Co., 17 Fed. Rep. 753; Swann *v.* Gaston, 87 Ala. 569; Millard *v.* Burley, 13 Nebr. 259; State *v.* Glenn, 18 Nev. 34; Metropolitan T. Co. *v.* N. Y. Tr. & W. R. Co., 45 Hun, 84.

[2] 143 U. S. 42 (1891). The doctrine of this case was followed in Wilson *v.* Beckwith (1893), 117 Mo. 61, as to the point that the word "appurtenances" does not cover the land-grant from the State.

unto belonging," covered a grant of lands within the State subsequently made by Congress to the company in aid of the construction of its road. The court said that the word "appurtenances," as ordinarily defined, was that which belonged to or was connected with something else to which it is subordinate or less worthy, and with which it passes as an incident, such as an easement or servitude to land; the tackle, apparel, rigging, and furniture of a ship; a right of common to a pasture, or a barn, garden, or orchard, to a house or messuage. The rule was affirmed that, in a strict legal sense, land could never be appurtenant to land; but the mortgage in question evidently contemplated the subsequent acquisition of real estate, such as land for stations, machine-shops, or other purposes immediately connected with the road, and this realty would pass under the lien or the mortgage, the general rule being modified to that extent by the intent of the parties. The land-grant in question, however, not being connected with the plant, and not forming a part of the organic structure of the road, could not be treated as appurtenant to it.

In Humphreys *v.* McKissock,[1] cited with approval in New Orleans Pacific Ry. Co. *v.* Parker, *supra*, it was held that the commissioner had "committed a manifest error" in ruling that an elevator was a common appurtenance to the roads of several railroad companies which owned the stock of the company which constructed the elevator, and therefore formed a part of the property which should pass to a receiver appointed in a suit to foreclose a mortgage executed by one of the railroad companies, and embracing the word "appurtenances." Mr. Justice Field said: "It is difficult to understand the course of reasoning by which a certificate of stock in an independent corporation can be an appurtenance to a railroad. If stock in the company in question could be considered an appurtenance to a railroad, by the same rule stock in a bank, or in any other corporation with which the railroad did business, might be so considered.

"But were we to consider the Wabash Company as possessing a separable legal interest in the elevator, it would not be appurtenant to its railroad. That building is situated at some distance from the railroad, — more than half a mile, — and is erected on land not belonging to that company, but leased from the Union Pacific Railway Company, and can only be reached by crossing the tracks of another company. Had the elevator been constructed upon property covered by the mortgage, it might have been contended that it fell, to the extent of the one-sixth interest,

[1] 140 U. S. 304 (1891).

under the mortgage, as one of the depots of the company. The term 'depot' in the mortgage is not necessarily limited to a place provided for the convenience of passengers while waiting for the arrival or departure of trains. It applies also to buildings used for the receipt and storage of freight, which, when received, is to be safely kept until forwarded by the cars of the company or delivered to the owner or consignee. Such a building, whether existing at the time of the mortgage or constructed afterwards upon the property of the company covered by it, may pass as an appurtenance to the property previously existing. A thing is appurtenant to something else only when it stands in the relation of an incident to a principal, and is necessarily connected with the use and enjoyment of the latter."

The learned justice then reviewed some earlier decisions and proceeded as follows: "Under the term 'appurtenances,' as used in the mortgage in question, only such property passes as is indispensable to the use and enjoyment of the franchises of the company. It does not include property acquired simply because it may prove useful to the company and facilitate the discharge of its business. A distinction is made in such cases between what is indispensable to the operation of a railway and what would be only convenient. Bank *v.* Tennessee (1881), 104 U. S. 493, 496. The elevator in question was at all times under an independent management, and was used in the same manner as any other warehouse not on the premises of the railway company to which it sent cars for freight." [1]

Whether a hotel erected by the company is "appurtenant" to the road depends upon whether the purpose is to use it for the convenience and comfort of the employees and passengers, thereby contributing to the proper conduct of the business of the company as a carrier. If the building fulfils that purpose it will pass as an appurtenance.[2]

This ruling was approved in a late Missouri case, where the same mortgage was under discussion. The court, however, laid more stress upon the fact that after-acquired "real estate" was referred to in unambiguous terms. For this reason, it was said, the effect of the mortgage did not depend on the technical meaning of the word "appurtenances," and it was not confined to such

[1] Humphreys *v.* McKissock (1891), 140 U. S. 304.

[2] United States Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1887), 32 Fed. Rep. 480. The mortgage in this case covered the entire line of road between designated points, "as said railroad is or may be hereafter constructed, maintained, operated, or acquired, together with all the privileges, rights, franchises, real estate, etc., and other appurtenances thereto belonging."

real estate as is acquired for the right of way, depot grounds, side tracks, etc. Although the words did not include real estate not used in connection with the road, they must be taken to comprehend any real estate which was acquired for use in its operation. Of this character was the real estate bought as a site of a building.[1]

If, on the other hand, the building is merely an ordinary hotel for the entertainment of many guests that may apply for accommodation, and neither solely nor in part a structure designed to subserve the convenience of passengers or employees, it is not covered by the word "appurtenances."[2]

In a Pennsylvania case the court upheld a finding of a jury that lots of land across the mere edge of which the track was laid, but which were not in any other way used for railroad purposes, but which had been held for many years after the original intention had been abandoned, were not appurtenant to the railroad.[3]

But an essentially different case is presented when the track is laid along the edge of lots, and the remainder of them either actually used for facilitating the business of transportation, or held with the *bona fide* intention of applying them to such uses at some future time.[4]

Lands to which the company has no valid title will not, of course, pass under a mortgage purporting to convey "the lands

[1] Omaha & St. Louis Ry. Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1891), 108 Mo. 298; s. c. 18 S. W. Rep. 1101. Compare the remarks of the court in New Orleans Pacific Ry. Co. *v.* Parker (1891), 143 U. S. 42, referred to above.

[2] Miss. Valley R. Co. *v.* Chicago, St. Louis, & New Orleans R. Co. (1881), 58 Miss. 896. The court conceded the soundness of the general principle that the things that may be deemed essential or useful, and therefore appurtenant to the great work of building and operating a railroad, will frequently be more extensive and varied in their character than those which can probably be regarded as accretions to the business of private persons, but held that the property in question could not possibly be regarded as either necessary or legitimate to the business of the railroad corporation.

[3] Shamokin Valley R. Co. *v.* Livermore (1864), 47 Pa. St. 465.

[4] Knevals *v.* Florida Central R. Co. (1894), 13 C. C. A. 410; s. c. 66 Fed. Rep. 224.

There the lots in question, which extended in part into the water of a harbor, were purchased for the purpose of furnishing terminal facilities where a projected system of lines was intended to reach the sea, and subsequently occupied by throwing out embankments or building wharves, until much of the company's business was transacted on the extensions thus secured. Under these circumstances the court held that the appropriation for railroad purposes was virtually complete as regards the whole tract, and refused to except any of it from the lien of the mortgage, or to countenance the narrow doctrine put forward by counsel, that only land which is in a strict sense "necessary" for the railroad is "appurtenant."

appertaining to the road." For example, such a phrase can have no operation as regards lands conveyed to the company in excess of the amount authorized by a statute passed for the purpose of aiding the construction of the road by a land-grant.[1]

§ 232. **What Personalty will pass under the Term "Appurtenances."**— The clause "all other personal property in any way belonging to or appertaining to the railroad of the said company" will not embrace "canal-boats" acquired to be used in connection with the business of the line, but beyond its terminus, and not subservient to railroad uses excepting so far as they facilitated the traffic in this way.[2]

It has also been held that railroad chairs, never actually used in the construction of the track, are not embraced under the term "appurtenances." [3]

It should be observed that many of the cases in which the mortgage is construed which contains the word "appurtenances" do not turn so much upon the meaning of that word as upon the proper application of the principle that property covered in general terms will not pass unless it is acquired for railroad purposes. The present section should, therefore, be read in connection with the one (§ 205) in which the wider question is the controlling feature.

ARTICLE X. — WHAT IS COVERED BY THE WORD "UNDERTAKING."

§ 233. **What the Word "Undertaking" embraces when used in Instruments creating Charges on Railroad Property.** — The earliest case on this point was decided largely with reference to the fact that the mortgagor company alone was authorized by the enabling act to gather tolls. The inference drawn was that a mortgage covering its undertaking did not amount to a demise of the land, nor empower the mortgagee to take possession of the road. Any other construction would, it was said, enable the mortgagee to put an end to the undertaking, inasmuch as he has no power to levy the tolls; and this supposition would be quite inconsistent with the evident purpose of the act, which is that the borrowed money shall be repaid by the carrying on of the undertaking by the company itself.[4]

[1] St. Paul, etc. Ry. Co. *v.* St. Paul, etc. Ry. Co. (1893), 57 Fed. Rep. 272.

[2] Parish *v.* Wheeler (1860), 22 N. Y. 494.

[3] Farmers' L. & T. Co. *v.* Commercial Bank (1860), 11 Wis. 207; s. c. 15 Wis. 424 (1862).

[4] Myatt *v.* St. Helens, etc. Ry. Co. (1841), 2 Q. B. 364, per Coleridge, J., who pointed out that the intention of the legislature was made still clearer by the provisiou declaring that the mortgagees should not be entitled to vote as shareholders.

This ruling was followed by another, to the effect that "an assignment of the 'undertaking' of a railroad company, and all the tolls and sums of money arising by virtue" of the act incorporating it, operates as a pledge of the tolls and property of the company as proprietors, but not their stock or property as carriers, or the soil of the railway itself.[1]

But the meaning of the word was not thoroughly settled until the delivery of the well-known opinion of Lord Cairns in Gardner *v.* London, etc. Ry. Co.,[2] where the nature and extent of the power of debenture-holders to enforce their security against the company's property, so far as that question depended on the effect of the pledge of the "undertaking," were thus defined.[3]

§ 234. **What the Word "Undertaking" embraces when used in Instruments creating Charges on Corporate Property other than Railways.** — The word "undertaking" is not invariable in meaning. The construction placed upon it, as it is used in railway debentures, is attributable to the peculiarity of the subject-matter on which those instruments operate, — that is to say, a permanent railway, known to every one to be permanent, and incapable of being mortgaged, sold, or dealt with in any way. A debenture bond of a steamboat company "charging the undertaking and all sums of

[1] Hart *v.* Eastern Union Ry. Co. (1862), 7 Exch. 246; 8 Exch. 116.

[2] L. R. 2 Ch. App. 202 (1867).

[3] Lord Cairns used these words: "The object and intention of Parliament, however, in the case of each of these various undertakings, was clearly to create a railway which was to be made and maintained, by which tolls and profits were to be earned, which was to be worked and managed by a company according to certain rules of management, and under a certain responsibility. The whole of this, when in operation, is the work contemplated by the legislature, and it is to this that, in my opinion, the name of 'undertaking' is given. Moneys are provided for, and various ingredients go to make up the undertaking; but the term 'undertaking' is the proper style, not for the ingredients, but for the completed work, and it is from the completed work that any return of moneys or earnings can arise. It is in this sense, in my opinion, that the 'undertaking' is made the subject of a mortgage. Whatever may be the liability to which any of the property or effects connected with it may be subjected through the legal operation and consequences of a judgment recovered against it, the undertaking, so far as these contracts of mortgage are concerned, is, in my opinion, made over as a thing complete or to be completed; as a going concern, with internal and parliamentary powers of management not to be interfered with; as a fruit-bearing tree, the produce of which is the fund dedicated by the contract to secure and to pay the debt. The living and going concern thus created by the legislature must not, under a contract pledging it as security, be destroyed, broken up, or annihilated. The tolls and sums of money *ejusdem generis* — that is to say, the earnings of the undertaking — must be made available to satisfy the mortgage; but, in my opinion, the mortgagees cannot, under their mortgages, or as mortgagees, — by seizing, or calling on this court to seize, the capital, or the lands, or the proceeds of sales of land, or the stock of the undertaking, either prevent its completion, or reduce it into its original elements when it has been completed."

money arising therefrom, and all the estate, right, title, and interest of the company therein, with the payment" of the sum named, with interest until the repayment of that sum, does not cover merely the income from the business, but all the property of the company, both that which exists at the date of the debenture and that which may afterwards be acquired. The meaning of the debenture is that the company will continue to transact its business, and that the debenture-holder cannot interfere until either the interest is in default, or the principal is not repaid when it matures. This being the relation between the parties, the conclusion necessarily follows that the moment the company comes to be wound up, and the property has to be realized upon, the rights of the debenture-holders attach, and that the general creditors can touch nothing till they are paid.[1]

[1] *In re* Panama, etc. Co. (1870), L. R. 5 Ch. App., per Gifford, L. J. See *In re* Streatham & General Estates Co. (1897), L. R. 1 Ch. 15, where debentures charged the undertaking and all its "property whatsoever and wheresoever, both present and future." The company went into liquidation. The debentures were held not to cover the uncalled capital as it existed at the commencement of the liquidation, distinguishing *Ex parte* Stanley, 33 L. J. Ch. 535.

What passes under a mortgage of the "undertaking:" see Legg *v.* Mathieson, 2 Giff. 71; Wickham *v.* New Brunswick, etc. Ry. Co., L. R. 1 P. C. 64.

What does not pass: see King *v.* Marshall, 33 Beav. 565; Moor *v.* Anglo-Italian Bank, 10 Ch. Div. 681. Charge upon after-acquired property: see *In re* General South American Co., 2 Ch. Div. 337; Willink *v.* Andrews, 16 Ir. C. L. 201; Blooner *v.* Co., L. R. 16 Eq. Cas. 384; Tailby *v.* Receiver (1888), 13 App. Cas. 546.

For a recent definition of a "floating security" in England, see Governments Stock, etc. Co. *v.* Manila Ry. Co. (1897), 1 L. R. App. Cas. 86, where Lord Macnaghten says: "A floating security is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying condition in which it happens to be from time to time. It is of the essence of such a charge that it remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favor the charge is created intervenes. His right to intervene may, of course, be suspended by agreement. But if there is no agreement for suspension, he may exercise his right whenever he pleases after default."

The following are statutes of some of the States referring to mortgages of "after-acquired" property: Iowa, Code 1884, McClain's, § 1995, power to mortgage after-acquired property. Minn., Gen. St. 1891, § 2530, same. Nebr., Comp. Stats. 1895, § 1822, same. N. Dak., Code 1895, § 2947, same. Okl., Stats. 1893, § 1020, same. Utah, Comp. L. 1888, § 2370, same.

CHAPTER XI.

PRIORITIES BETWEEN MORTGAGES AND OTHER OBLIGATIONS OF THE COMPANY.

ARTICLE I. — PRIORITIES CONSIDERED WITHOUT REFERENCE TO THE SPECIAL EFFECT OF AN "AFTER-ACQUIRED PROPERTY" CLAUSE.[1]

§ 235. **Existing Liens are not displaced by Mortgage.** — Except in so far as the registration laws have modified the practical applica-

[1] See also Chap. XXXIV., distribution of proceeds; Chaps. I. and VII., as to priorities so far as they depend on the validity of the bonds; Chaps. II. and III.,

tion of the principle embodied in the maxim, *qui prior est in tempore prior est in jure* (see next section), it is clear that no existing lien can be displaced by a mortgage.

This rule is applicable in a case where a judgment lien was fastened on the corporate property, while the persons who organized the corporation were carrying on business, after having taken some steps towards organization, but before such organization was completed. Third persons should not suffer from such an irregularity; and since the corporators were holding themselves out as a corporation when the lien was claimed to attach to their property, it will be preferred to the lien of a mortgage executed after the organization is legally perfected.[1]

So also, where the superiority of the judgment lien has once been fixed in accordance with the laws prevailing at the time of its rendition, the creditor thus acquires a vested right in the property to which the lien attaches, and he cannot be deprived of such right by subsequent legislation which validates a void mortgage on the same property,[2] or makes the claims of certain employees for wages a paramount claim on that property.[3]

§ 236. **Priorities as affected by the Registration Laws.** — The effect of the registration laws in modifying the operation of the rules of equity by which priorities are determined is too extensive a subject to enter upon in the present treatise, especially as there are no rules specially applicable in this connection to corporate obligations. In the present section we shall merely collect such cases under this head as have a direct bearing on the rights of the holders of corporate securities.

The necessary effect of the registration laws is to postpone a judgment lien which attaches after the record of a duly executed mortgage to the lien of that mortgage.[4]

as to priorities so far as dependent on whether a bondholder is a *bona fide* purchaser or not; Chap. XXVIII., as to priority of "preferential claims." On the priority of claims for labor and materials over lien of railroad mortgages, see article by Charles Chauncey Savage, 21 Cent. L. J. 125 (1885). On the rights of material-men and employees of railroad companies as against mortgagees, see article by George Tucker Bispham, 6 So. L. Rev. N. S. 535 (1880). On postponing the priorities of first liens, see article in 13 Am. L. Rev. 40. On what claims are prior liens to railway mortgages, see 3 Cent. L. J. 636 (1876). On liens for railroad supplies, see article in 4 Cent. L. J. 544 (1877). On rights of material and supply men in railroad foreclosures, see article in 30 Am. Law Rev. 520 (1896). On priority over mortgage of debts contracted by railroad before receivership, see article in 39 Cent. L. J. 241 (1894).

[1] Bergen *v.* Porpoise Fishing Co. (1886), 42 N. J. Eq. 397; s. c. 2 Cent. Rep. 461; 8 Atl. Rep. 523.

[2] Williamson *v.* New Jersey Southern R. Co. (1878), 29 N. J. Eq. 311; Coe *v.* New Jersey Midland Ry. Co. (1879), 31 N. J. Eq. 105.

[3] Coe *v.* New Jersey Midland Ry. Co. (1879), 31 N. J. Eq. 105.

[4] Morton *v.* New Orleans & Selma Ry. Co. (1885), 79 Ala. 590.

A like preference is given to an unrecorded mortgage of which the judgment creditor has actual notice, and this priority prevails against both the creditor himself[1] and his assignee. Whether the latter has or has not notice in such a case is immaterial.[2]

If a railroad mortgage is properly recorded in some of the counties through which the road passes and not in others, the judgment lien will prevail as to the latter portion of the property.[3]

The converse question, namely, whether a judgment is inferior or not to a lien of which the creditor has no notice, either actual or constructive, must be decided with reference to the effect of the registration laws, which in this respect may either leave the judgment creditor to his common-law rights, or place him in the favored position of a subsequent purchaser without notice.[4]

Where a statute has the former effect, the lien of the judgment is deemed to attach merely to the interest actually possessed by the defendant, and if his ownership is subject to secret equities, the operation of the judgment lien is proportionately contracted.[5]

But although the registration laws may protect the judgment creditor against secret liens, and, through him, the purchaser at the execution sale, this protection does not extend to one purchasing at an execution sale under a judgment against a subsequent grantee of the property burdened with the secret lien, even though the grantee has notice of such lien.[6]

[1] Mead *v.* New York, Housatonic, & Northern R. Co. (1879), 45 Conn. 199; Mississippi Valley Co. *v.* Chicago, St. Louis, & New Orleans R. Co. (1881), 58 Miss. 896.

[2] Butler *v.* Rahm (1877), 46 Md. 541. Compare Farmers' Loan & Trust Co. *v.* Hendrickson (1857), 25 Barb. 484; Bement *v.* Plattsburgh & Montreal R. Co. (1866), 47 Barb. 104.

[3] Ludlow *v.* Clinton Line Railroad Co. (1861), 1 Flip. 25.

[4] Freeman on Judgments, § 366 (*a*). Against secret vendors' liens many courts have held that the creditor should be protected, irrespective of the recording statutes. Warvelle on Vendors, p. 701; Fisk *v.* Potter (1865), 2 Abb. Ct. App. Dec. 138.

[5] Freeman on Judgm., *loc. cit.*

[6] Mississippi Valley Co. *v.* Chicago, St. Louis, & New Orleans R. Co. (1881), 58 Miss. 896. In this case the plaintiff was the assignee of a creditor who had obtained judgment against a company formed by consolidation of two other companies, the obligations of which it assumed. Prior to the consolidation, one of the companies had executed a mortgage on its property which was not recorded. The court distinguished the case from one in which the plaintiff might have been the creditor of the mortgagor himself, and held that the protection which the registration laws would have afforded under the latter circumstances could not be extended to the creditors of subsequent grantees of the mortgagor. Judgments for penalties under a statute of Arkansas prescribing a penalty for excessive charges for passage or freight against a railroad company were ordered to be paid in a foreclosure suit in preference to the bondholders in Mercantile Trust Co. *v.* St. Louis & S. F. Ry. Co. (Ogden *et al.*, Interveners), (1895), 69 Fed. Rep. 193.

Where the other doctrine prevails, the lien of a mortgage will not prevail against that of a subsequent judgment, obtained without notice of the existence of the mortgage, unless it has been duly registered before the rendition of the judgment.[1]

Holders of mortgage bonds of a corporation have a lien on the mortgaged property of the corporation relating back to the date of record of the mortgage, and the mortgage from that date will be deemed an incumbrance upon the mortgaged property prior to claims for mechanics' liens and the like for improvements made subsequent to the record of the mortgage.[2]

Under the general system in force in this country, the mere fact that the lienor holds some fiduciary relation to the company would probably not make his omission to register his lien fatal to the extent of incapacitating him from setting it up against unsecured creditors;[3] but this consequence follows if such a lienor fails to comply with section 43 of the English Companies Act of 1862, requiring incumbrances on the property of any company formed under that act to be registered. Thus directors who take a mortgage on the corporate property and omit to register it,[4] or, in registering it, give no description of the property,[5] will not be permitted to set it up against the general creditors.

The same rule is applicable where a solicitor is employed in a certain transaction, and receives a charge on the property as a security for his costs.[6]

But the bankers of a company are not its officers in such a sense as to invalidate to this extent unregistered mortgages given to them by the company.[7]

Nor is a shareholder who takes a debenture, charging the entire property of the company, precluded from asserting the priority of his lien against the general creditors of the company, even though

[1] Farmers' Loan & Trust Co. *v.* St. Jo. & Denver City R. Co. (1875), 3 Dill. 412.

[2] Central Trust Co., Trustee, *v.* Continental Iron Works (1893), 51 N. J. Eq. 605; s. c. 28 Atl. Rep. 595. The Court of Errors and Appeals said: "Bonds of corporations secured as are these bonds are dealt with in commercial transactions, and are treated almost without exception by the courts as a class by themselves, not subject in all respects to the stricter rules which pertain between natural persons." See on this point Claflin *v.* Railroad Co. (1880), 4 Hughes, 12; Neilson *v.* Iowa Eastern R. Co. (Iowa, 1875), 8 Am. Ry. Rep. 82; Reed's Appeal (1888), 122 Pa. St. 565.

[3] See, however, the decisions cited in Chapter VIII., as to the results in some States of failing to comply with the Chattel Mortgage Acts.

[4] *In re* Wynn Hall Coal Co. (1870), L. R. 10 Eq. 515.

[5] *In re* Nature Iron Ore Co. (1876), L. R. 2 Ch. Div. 345.

[6] *Ex parte* Valpy & Chaplin (1872), L. R. 7 Ch. App. 289.

[7] *In re* General Provident Ass. Co. (1872), L. R. 14 Eq. 507.

the officers have not performed the duty incumbent on them of keeping the register of liens in a proper form.[1]

§ 237. **Priorities as Dependent on the Terms of the Decree ordering the Sale at which Mortgagor purchased the Property.** — Any liability which a purchaser at a judicial sale is required to assume as a condition of acquiring the property constitutes a lien thereon which is paramount to a later deed of trust executed by the purchaser. The mortgagee under such circumstances is bound to know that the title of the mortgagor is based on the decree, and any order made when the sale is confirmed.[2]

§ 238. **Priority of Judgment Lien established by State Statute is recognized by Federal Courts.** — If State legislation makes a judgment for personal injuries a lien on the railroad property superior to the lien of all mortgages executed after a certain date, this lien will be recognized in a federal court, and declared to extend not only to the costs in that court itself, but also to those incurred, during the progress of the action, in the State court.[3]

The lien of a judgment rendered in the Circuit Court of the United States attaches to the property of the debtor through the district in which it is held, as does that of a judgment in the State court to the property in the county in which it is rendered.[4]

§ 239. **Claims not protected by Specific Liens are necessarily postponed to a Later Mortgage on the Corporate Property.** — The operation of this rule is not affected by the fact that the mortgagor is a purchaser of the property of the company by whom the debt was incurred, and has agreed to assume and pay it as a part of the consideration of the purchase. Such an agreement does not invest the claim with any higher dignity than it previously possessed.[5]

§ 240. **Existing Mortgage, how far affected by Creation of Subsequent Obligations. — General Principles.** — That a lien created on the property after the execution of a valid and duly recorded mortgage must, apart from the effect of the registration laws, take rank after the mortgage unless the mortgagee waives his

[1] *In re* General South American Co. (1876), L. R. 2 Ch. Div. 337.

[2] Central Trust Co. *v.* Sloan (1885), 65 Iowa, 655; s. c. 23 Am. & Eng. R. R. Cas. 398; 22 N. W. Rep. 916.

[3] Central Trust Co. *v.* Central Iowa Ry. Co. (1889), 38 Fed. Rep. 889.

[4] Ludlow *v.* Clinton Line R. Co. (1861), 1 Flip. 25. Under such a judgment, the line of the road passing through more than one county, a sale of the road as an entirety must be made according to the manner prescribed by the statutes of the State in which it is situated for the sale of a tract of land lying in different counties.

[5] Fogg *v.* Blair (1889), 133 U. S. 534; s. c. 10 Sup. Ct. Rep. 338. See further, Chap. XXXIV. (distribution of proceeds).

paramount right, or unless he has taken his security subject to the contingency of its being postponed to subsequent claims the creation of which was contemplated at the time the contract was entered into, is a proposition which necessarily results from the legal relations created between the parties by the instrument. The rule itself is illustrated by the well-settled doctrine that a properly executed and duly recorded mortgage, given by a railroad company on its road-bed or other property, creates a lien which cannot be displaced thereafter, either directly by a mortgage, or indirectly by a contract between the company and a third party for the erection of buildings or other works of original construction.[1]

Still less is a sub-contractor whose agreement is wholly with the principal contractor entitled to have a mere money judgment which he obtains against the company declared a lien on the property prior to that of an earlier mortgage on the same property.[2]

Bondholders secured by a mortgage executed and recorded before the passage of the Ky. act, March 27, 1888, giving a lien for construction of a railroad, declaring this "said lien shall be prior and superior to all other liens theretofore or thereafter created thereon," will have priority under their mortgage lien over the lien of contractors, even though their bonds may have been issued to them subsequently to the passage of the act.[3]

The first exception to the rule finds an illustration in a case where the bondholders consented to the issuance of new bonds which were, by express stipulation, to be preferred to their own.

[1] Toledo, D. & B. R. Co. *v.* Hamilton (1890), 134 U. S. 296; s. c. 10 Sup. Ct. Rep. 546. On debentures *expressly* subject to prior debentures, see 3 Rep. (Chy.) 363.

[2] Coe *v.* East & West R. Co. of Alabama (1892), 52 Fed. Rep. 531.

[3] Central Trust Co. of New York *v.* Louisville, St. L. & Texas R. Co. (1895), 70 Fed. Rep. 282. See Claflin *v.* Railroad Company (1880), 8 Fed. Rep. 118; Central Trust Co. *v.* Continental Iron Works (1893), 51 N. J. Eq. 605; s. c. 28 Atl. Rep. 595, holding that mortgages for future advances operate from the time of recording, although the advances are not made until a subsequent date, and they have priority for all advances made before actual notice of subsequent incumbrances. When between the time of the execution and recording of a mortgage, and the issue of the mortgage bonds thereon, a mechanic's lien attaches to the mortgaged premises, the holders of such mortgage bonds, without actual notice of the mechanic's lien, have a lien on the mortgaged premises relating back to the time the mortgage was recorded, prior and superior to that of the mechanic's lien. See also Reed's Appeal (1888), 122 Pa. St. 565; s. c. 16 Atl. Rep. 100; Neilson *v.* Iowa Eastern R. Co. (Iowa, 1875), 8 Am. Ry. Rep. 82, 88; Newgass *v.* Atlantic & D. Ry. Co. (Central Car Trust Co., Intervener), (1893), 56 Fed. Rep. 676, which appears to take a contrary view, and which the court, in Central Trust Co. of New York *v.* Louisville, St. L. & T. R. Co., *supra*, said did not clearly show that the question there was material, and, it was plain, it was not presented and argued.

Such a transaction was deemed equivalent to a pledge of their interest under the first mortgage, and left that interest otherwise intact and enforceable subject to the new lien. In such a case an equitable lien is created taking precedence of the mortgage, as against all the bondholders who assent to the contract. The others retain all their rights under the mortgage, but gain nothing except such increased value as their security may acquire from the transaction.[1]

A second exception to the general rule arises in those cases where the mortgagees take their security subject to the rights created by laws which confer a more or less absolute priority of claims of certain kinds, or to the analogous rights which, under the prevailing practice of courts of equity in foreclosure suits, are accorded to creditors of a few specified classes. The cases dealing with rights of the latter description will be reviewed in a subsequent chapter (Chap. XXVIII., preferential debts). The statutes enlarging the common-law rights of persons who furnish labor and materials are referred to in Article III. of the present chapter, in so far as they have been discussed in cases bearing upon the rights of the holders of corporate securities.

§ 241. **Traffic Agreement, when not a Lien on the Corporate Property.** — An agreement between two companies providing, among other things, for the use of a portion of the road of one of them by the other, does not create an obligation running with the land, so as to be entitled to precedence over a subsequent mortgage on the property of either of the companies, although it is stipulated that "the contract, and any damages for the breach of the same, shall be a continuing lien upon the roads, and their equipment and income, into whosesoever hands they may come."[2]

§ 242. **Priority expressly reserved, may be lost by Estoppel.** — Although a construction contract antedating the mortgage has been so drawn as to give the contractor a paramount lien upon the property, as where it is provided that he shall retain the possession of the road, and receive its issues and profits until the completion of the contract, yet if the contractor transfers bonds received by him as payment for work, such bonds giving the trustees a right of entry upon default, he will be estopped, as

[1] Poland *v.* Lamoille Valley R. Co. (1879), 52 Vt. 144. Compare the cases where bondholders surrender their bonds and accept new evidences of debt, Chap. II., *ante;* Chap. XIII. (statutory liens); Chap. XXXIV. (distribution of proceeds). On priority of subsequent mortgage bonds to debentures, see (1897), 1 L. R. App. Cas. 81; s. c. 2 Chy. 551; also Co. *v.* Brunton, 4 Rep. (Q. B.) 58.

[2] Des Moines & Fort Dodge R. Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1890), 135 U. S. 576; 40 Am. & Eng. R. R. Cas. 694; 10 Sup. Ct. Rep. 753.

against those trustees, from asserting his right of possession under his contract. The transfer, therefore, will operate as a waiver of his rights under that contract.[1]

§ 243. **Priorities not disturbed by Consolidation.**[2]—The general rule is that, if no arrangements are made respecting the liabilities of a corporation which consolidates with another, the liabilities of the constituent companies are enforceable against the new one, in the same way as if no change had been made.[3]

But it is usual to embody in statutes, whether general or special, authorizing consolidation a provision recognizing this rule in terms of greater or less precision, and the decisions dealing with the liabilities of consolidated companies have practically turned upon the construction of such provisions.

The fact that a statute incorporating a consolidated company declares that such consolidation "shall in no way affect the rights of the creditors" of the constituent companies, operates as constructive notice to all the world of the existence of any claims still outstanding against those companies. Purchasers of the bonds of the consolidated company, therefore, will be subordinated to the holders of unpaid bonds secured by a mortgage on the property of one of the constituent companies, so far as regards that property itself, although the new bonds are issued as first-mortgage bonds under a statute the terms of which are such that the offer of the bonds amounts to an official certification that all prior liens on the road have been paid and cancelled.[4]

The New York act of 1869 (ch. 917), which authorized the consolidation of railroad companies, provided that "all debts and liabilities incurred by either of the (constituent) corporations *except mortgages*, shall thenceforth attach to such new (consolidated) corporation." It has been held that this provision does not deprive the holder of bonds of one of the constituent companies from suing on the bonds themselves. The word "mortgages" in such a case cannot be construed as meaning "mortgage debts," and the exception merely expresses the intention of the legislature that the property lien of the mortgages shall be confined to the property theretofore held by each of the consolidating companies.[5]

[1] Allen *v.* Dallas & Wichita R. Co. (1878), 3 Woods, 316.

[2] On the general subject of the liability of a consolidated company for the debts of its predecessors, see note, 23 Lawyers' Rep. Ann. 231.

[3] Thompson on Corp., § 372.

[4] Spence *v.* Mobile & Montgomery Ry. Co. (1885), 79 Ala. 576.

[5] Polhemus *v.* Fitchburg Railroad Co. (1890), 123 N. Y. 502; s. c. 46 Am. & Eng. R. R. Cas. 330; 26 N. E. Rep. 31.

ARTICLE II. — PRIORITIES CONSIDERED WITH REFERENCE TO THE SPECIAL EFFECT OF AN "AFTER-ACQUIRED PROPERTY" CLAUSE.

§ 244. **The General Rule** is that a mortgage of after-acquired property binds that property as against the mortgagors and all persons claiming under them, except purchasers for value and without notice, and against junior judgment-creditors.[1]

It will, therefore, prevail against a subsequent mortgagee with actual or constructive notice of its existence;[2] or against a company which, with notice of the lien, purchases the various rights and interests of another company in a road which is in process of construction, and upon which a mortgage with the usual "after-acquired property" clause has been given. In such a case the lien covers the entire road, and not merely the completed part in payment for which the bonds were issued, and the purchasers take their acquisition *cum onere*, and the lien is in no way displaced after the road has been built by them.[3]

The title of the purchasers of certificates for public lands to be received by the company on the completion of its road, if those purchasers have no notice of the trust deed, will be preferred to the claims of the bondholders.[4]

One who purchases the personal property of the company with knowledge of the fact that it is covered by a mortgage containing an "after-acquired property" clause, and that this mortgage expressly provides that no such sale shall take place except with the assent of the trustees, stands in the position of a purchaser with full notice of the prior equities of the bondholders. His rights in the property, therefore, are inferior to those of the bondholders and of a company to whom the road passes in subsequent foreclosure proceedings.[5]

A subsequent attachment or judgment lien is also postponed to the after-acquired clause.[6]

1 Stevens *v.* Watson (1865), 4 Abb. Ct. App. Dec. 302. In Little Rock & Fort Smith Ry. Co. *v.* Page (1880), 35 Ark. 304; s. c. 7 Am. & Eng. R. R. Cas. 36, it was said that "equity binds everybody to respect the equitable lien [created by the after-acquired clause], who knows of it, or without knowing of it, has got the property without valuable consideration."

2 Morrill *v.* Noyes (1863), 56 Me. 458; Willink *v.* Morris Canal & Bkg. Co. (1843), 4 N. J. Eq. 377; Steven *v.* Watson (1865), 4 Abb. Ct. App. Dec. 302; Farmers' Loan & Trust Co. *v.* Commercial Bank (1860), 11 Wis. 207.

3 Wade *v.* Chicago, S. & St. Louis R. Co. (1893), 149 U. S. 327; s. c. 13 Sup. Ct. Rep. 892.

4 Campbell *v.* Tex. & New Orleans R. Co. (1872), 2 Woods, 263.

5 Little Rock & Fort Smith Ry. Co. *v.* Page (1880), 35 Ark. 304; s. c. 7 Am. & Eng. R. R. Cas. 36.

6 Seymour *v.* Canandaigua & Niagara Falls R. Co. (1857), 25 Barb. 284; Loudenslager *v.* Benton (1861), 4 Phil.

But this rule must of course be considered with reference to the very important exceptions introduced by the legislation which has raised certain debts incurred in construction or in the operation of the road to a favored position, and by the decisions of courts of equity regarding the so-called preferential debts. With regard to preferential debts it should be remembered that, although such debts have frequently been reduced to judgment before being presented as claims against the property of the company, their priority over the mortgage is not in the least dependent upon whether judgment has been obtained or not. It is not necessary to the right of intervention to participate in a trust fund *in custodia legis*, that the intervener should first obtain judgment at law, or that he should have any lien on the fund.[1]

§ 245. **After-acquired Property passes cum onere.** — A mortgage intended to cover after-acquired property can only attach itself to such property in the condition in which it comes into the mortgagor's hands. If the property is already subject to mortgages and other liens, the general mortgage does not displace them, although they may be junior to it in point of time. It only attaches to such interest as the mortgagors acquire, — no more, no less.[2]

Thus the lien of a prior mortgage on a purchased road will take precedence of a general mortgage on the property of the purchasing company.[3]

Similarly, if a railroad company, by accepting the benefit of a contract made by another company, whose road it acquires, estops itself from repudiating the contract, it will take the road with the obligation of doing that which was the consideration of the contract, and the trustees of a mortgage covering the road will also take the property *cum onere*.[4]

382; Coe *v.* Knox County Bank (1859), 10 Ohio, 412; Dunham *v.* Isett (1863), 15 Iowa, 284; Stevens *v.* Watson (1865), 4 Abb. Ct. App. Dec. 302; Covey *v.* Pittsburg, Ft. Wayne, & Chicago R. Co. (1858), 3 Phil. 173; Howe *v.* Freeman (1860), 14 Gray, 566; Hamlin *v.* Jerrard (1881), 72 Me. 62; s. c. 4 Am. & Eng. R. R. Cas. 488; United States *v.* New Orleans Railroad (1870), 12 Wall. 362; Fosdick *v.* Schall (1878), 99 U. S. 235; Pennock *v.* Coe (1860), 23 How. 117; Calhoun *v.* Memphis R. Co. (1829), 2 Flip. 442; Meyer *v.* Johnston (1875), 53 Ala. 337; St. Louis, A. & T. R. Co. *v.* Whitaker (1887), 68 Tex. 630; s. c. 5 S. W. Rep. 448.

1 Farmers' Loan & Trust Co. *v.* Missouri, I. & N. Ry. Co. (1884), 21 Fed. Rep. 264; s. c. 17 Am. & Eng. R. R. Cas. 314, citing Barton *v.* Barbour (1881), 104 U. S. 126.

2 United States *v.* New Orleans Railroad (1870), 12 Wall. 362.

3 Branch & Sons *v.* Atlantic & Gulf R. Co. (1879), 3 Woods, 481.

4 Coe *v.* Delaware, Lackawanna, & Western R. Co. (1881), 34 N. J. Eq. 266; s. c. 4 Am. & Eng. R. R. Cas. 513.

So also the lien for damages assessed against a company for land condemned by it for its right of way is superior to the lien of a prior mortgage covering the property;[1] and the same rule holds in regard to a claim for consequential damages resulting from the construction and maintenance of a railroad on a street.[2]

A right of a similar character is created where the company, instead of taking proceedings in eminent domain, enters into a written contract with the landowner, after the track has been constructed over his property, stipulating to pay him a certain amount in cash, and perform, within a certain time and under a certain penalty, work which was necessary in order to give convenient access to the lot, and the landowner agrees at the same time to give the company a right of way over the land, he himself retaining the legal title. Here the company's title is at most merely equitable; and a mortgagee of the company, being chargeable with notice of the nature of that title and the circumstances under which the company has possession of the land, cannot be regarded as a *bona fide* purchaser for a valuable consideration. He takes only the equitable rights of the company, and takes them with the obligation of doing the work which the contract called for.[3]

In Pierce *v.* Emery[4] it was held that the lien of a mortgage embracing after-acquired personalty would prevail against a later mortgage given by the company to secure a party who had advanced money to pay the government duties on certain materials within the scope of the mortgage, and had allowed these materials to pass into the possession of the company. The court also refused to accept the view that the lien of the government was transferred to the lender of the money by which it was discharged. The latter ruling is doubtless correct; for it is a familiar principle that the benefit of a lien does not pass to one who discharges it merely because he had discharged it. But the former position seems to be inconsistent with the doctrine laid down at the beginning of this section; provided, that is to say, the mortgage securing the lender of the money was given simultaneously with and

[1] Western Penn. R. Co. *v.* Johnston (1868), 59 Pa. St. 290. Under the constitution of Pennsylvania the company has no title or interest of any kind in the land, not even an easement, until the proprietor has been paid therefor, or his damages secured. To the same effect see Coe *v.* New Jersey Midland Ry. Co. (1879), 31 N. J. Eq. 105.

[2] Mercantile Trust Co. *v.* Pittsburg & Western R. Co. (1887), 29 Fed. Rep. 732.

[3] Hooper *v.* Savannah & Memphis R. Co. (1881), 69 Ala. 529; s. c. 14 Am. & Eng. R. R. Cas. 256.

[4] 32 N. H. 484 (1856).

as a part of the arrangement resulting in the discharge of the lien, — an important point, upon which the report throws no light. There is no apparent reason why the reservation of a lien on personalty should be a privilege conceded to a vendor alone. Doubtless the view of the court was largely influenced by the ground taken as to the principle on which an "after-acquired property" clause operates; viz., that a railroad is an entire thing, and it is very questionable whether the more generally received doctrine regarding such a clause, as being in effect an executory agreement, can be reconciled with the decision here rendered.

§ 246. **Vendor's Lien, how far preferred generally.**[1] — If a vendor's lien is reserved upon property sold either by a formal purchase-money mortgage, a purchase-money bond, or in any other manner, it will be given precedence of the lien attaching to the same property by virtue of the "after-acquired property" clause of a prior general mortgage executed by the mortgagor.[2]

In New York, however, a doctrine which seems scarcely reconcilable with the cases just cited has been propounded, the court holding that where a landowner sells land to a railroad company and reserves a lien for the purchase-money, the circumstances constitute a case in which a secret equitable lien and a recorded legal lien attach simultaneously to the same property, and for this reason the mortgage must be given preference.[3]

This view that the after-acquired clause creates a legal lien appears to be contrary to the theory of Pennock *v.* Coe[4] and other cases which are based upon the principle that mortgages of after-acquired property are given effect because they raise an executory contract for valuable consideration which the contractee is entitled to have specifically performed.[5] (See Chap. X.)

It is true that the court attached great importance to the fact that the vendor had been agent for the company in procuring lands for railroad purposes, but it is plain that the decision was

[1] This and the following sections should be read in connection with Chapter XIV., on car trusts.

[2] United States *v.* New Orleans Railroad (1870), 12 Wall. 362; Williamson *v.* New Jersey Southern R. Co. (1877), 28 N. J. Eq. 277; Frank *v.* Denver & R. G. R. Co. (1885), 23 Fed. Rep. 123; Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467; Loomis *v.* Davenport & St. Paul R. Co. (1882), 3 McCrary, 489; Manhattan Trust Co. *v.* Sioux City Cable Ry. Co. (1896), 76 Fed. Rep. 658; Blake *v.* Pine Mountain Iron & Coal Co. (1896), 76 Fed. Rep. 624; New York Security & Trust Co. *v.* Capital Ry. Co. (Phœnix Ironworks, Intervener), 77 Fed. Rep. 529; Brady *v.* Johnson, 75 Md. 445; Galt *v.* Erie & N. R. Co., 15 Grant's Ch. (Up. Can.) 637.

[3] Fisk *v.* Potter (1865), 2 Abb. Ct. App. Dec. 138.

[4] 23 How. 117.

[5] This principle is fully recognized in New York. See Kribbs *v.* Alford (1890), 120 N. Y. 519; s. c. 24 N. E. Rep. 811.

intended to rest on the more general principle also. The whole question hinges on the correctness of the assumption that the lien of the after-acquired clauses is of a legal nature. That assumption is not borne out by the authorities.

If the property sold is personalty, the equitable rule will sometimes be qualified by the laws regarding registration. Thus a federal court sitting in Iowa has held that verbal unrecorded agreements, that the title to personalty shall remain in the vendor until the property is paid for, are invalid and ineffectual against a general mortgage covering the same property.[1]

The rights of the vendor of personalty who is induced by fraudulent means to part with his property under color of a contract to purchase are, as against a mortgage, the same as those of a vendor who explicitly reserves a lien. No title in such a case passes to the vendee, and the property may be reclaimed at any time before it passes into the hands of a *bona fide* purchaser.[2]

§ 247. **Priority of a Vendor's Lien where the Property sold is a Fixture.** — This question depends upon which class of fixtures the subject of the agreement belongs to. In the present point of view there is a radical distinction between articles which actually became part of the realty and those which are merely attached to the realty in such a manner that they may be detached therefrom without being destroyed or materially injured, and without the destruction of, or material injury to, the things real with which they are connected. In the former class is reckoned personalty which is worked up into bridges, depots, and other structures, or used for laying the track. The rule as to personalty of this description is that, by no agreement of the vendor can it be made to retain its character as personalty, so far as the mortgagee is concerned.[3]

So also the mortgage will prevail against an agreement made by a bridge company that the bridges built by it should continue to be its property until fully paid for, and that in default of such

[1] Taylor *v.* Burlington, C. R. & M. Ry. Co. (1877), 4 Dill. 570. The seller in this case claimed a mechanic's lien also upon the property (locomotives), but did not prevail on this ground either, as he had taken "collateral security" within the meaning of the statute.

[2] Williamson *v.* New Jersey Southern R. Co. (1878), 29 N. J. Eq. 311; s. c. 15 Am. Ry. Rep. 572.

[3] Galveston Railroad *v.* Cowdrey (1870), 11 Wall. 459, where a vendor's lien on rails was postponed to the mortgage, after they had become part of the track. This case was decided with reference to the law of the State, where there was no special statute for the benefit of material-men. Compare the remarks in Fosdick *v.* Schall (1878), 99 U. S. 235; McGraw *v.* Memphis & Ohio R. Co. (1868), 5 Cold. (Tenn.) 434.

payments they should have the right to remove the materials used for the bridges.[1]

In the second class will fall personalty, such as telegraph poles erected on the right of way. As to these an agreement that they shall retain the character of personalty is valid without the assent of the mortgagee.[2]

So the lien of a vendor of machinery which has been attached to property subject to a mortgage covering after-acquired property ranks above the lien of the mortgage.[3]

§ 248. **Lien when defeated by Vendor's Acts.** — A vendor's lien may be lost by *laches* in setting it up, as where it is not asserted till after the foreclosure sale.[4]

An estoppel on the ground of *laches* and want of caution is more readily inferred in the case of a vendor who has been an agent for the company in procuring lands for its use.[5]

Or the vendor's conduct may be such that he is estopped as against the mortgagees from asserting his claim to the property; as where he puts the vendee into possession of the land, and executes and places in the hands of the latter a deed for the land sold, with an understanding that the deed should not be considered as delivered until the purchase-money had been paid, and the vendee afterwards puts the deed on record and mortgages the land for value.[6]

[1] Porter *v.* Pittsburg Bessemer Steel Co. (1887), 122 U. S. 267; s. c. 7 Sup. Ct. Rep. 1206. The court said: "The bridges became a part of the permanent structure of the railroad, as much so as the rails laid upon the bridges, or upon the railroad outside the bridges. Whatever is the rule applicable to locomotives and cars and loose property susceptible of separate ownership and of separate liens, and to real estate not used for railroad purposes, as to their being unaffected by a prior mortgage given by a railroad company covering after-acquired property, it is well settled in the decisions of this court that rails and other articles which became affixed to and a part of a railroad covered by a prior mortgage will be held by the lien of such mortgage in favor of *bona fide* creditors, or against any contract between the furnisher of the property and the railroad company containing stipulations like those in the present case."

[2] Western Union Tel. Co. *v.* Burlington, C. R. & N. R. Co. (1882), 3 McCrary, 130. In Haven *v.* Emery (1856), 33 N. H. 66, the language of the court would indicate that it regarded rails as being in the same category. But the case deals with the rights of a *subsequent* mortgagee, who had notice of an agreement between the vendor and the company that the rails should be the property of the former until paid for. The case, therefore, is not parallel to those in which the rights of a prior mortgagee claimed under an "after-acquired property" clause are in question.

[3] Wood *v.* Holly Manufacturing Co (1893), 100 Ala. 326; s. c. 13 So. Rep. 948.

[4] Pierce *v.* Milwaukee R. Co. (1869), 24 Wis. 551.

[5] Fisk *v.* Potter (1865), 2 Abb. Ct. App. Dec. 138.

[6] Resor *v.* Ohio & Mississippi R. Co. (1866), 17 Ohio St. 139.

If the vendor of personalty by his acts turns a conditional delivery into an absolute one, his position will be changed to that of a general creditor of the company.[1]

Article III. — Priority of Mortgages as modified by Legislation in Favor of Certain Classes of Creditors.

§ 249. **General Statement.** — All the States have passed statutes the general result of which has been to place the claims of mechanics and material-men in a more favored position than they occupied under common-law rules, and in some jurisdictions the same policy has been pursued with regard to other debts arising out of the operation of the road. To enter upon a discussion of these statutes would of course be altogether beyond the scope of the present treatise, but it will be useful to collect the decisions in which these statutory rights have actually come into collision with those of holders of corporate bonds. The phraseology of the various statutes is extremely diversified, and the cases decided in one State are often only of partial value as precedents in another. From the point of view of a bondholder the most important fact to remember is that the statutes belong, broadly speaking, to two classes, — that in which the legislature has gone no further than to raise these claims to the rank of secured debts, leaving the question of priority to be decided by ordinary rules, and that in which the claims have been given an absolute priority over all mortgages upon the property of the debtor.[2]

§ 250. **Lien of Mortgage not displaced by Subsequent Legislation.** — The general rule that a statute passed after the execution of a mortgage will not affect any rights created by it has been applied to statutes for the protection of material-men,[3] and to an act mak-

[1] Manchester Locomotive Works *v.* Truesdale (1890), 44 Minn. 115; s. c. 46 N. W. Rep. 301; 8 Ry. & Corp. L. J. 226.

[2] In National Foundry & Pipe Works (Lim.) *v.* Oconto Water Co. *et al.* (1895), 69 Fed. Rep. 1006, a mortgage had been executed by the corporation on September 13, 1890, by its officers, without the authority of the board of directors, and without a corporate seal. On the 15th day of September it was delivered to a bank, which made an advance of money on it. On September 15, a mechanic's lien accrued on the property included in the mortgage. On October 29, 1890, the mortgage was ratified by the directors and stockholders, and a formal instrument executed under the corporation, sealed and antedated September 13. The mortgage was held not to operate to create a lien prior to the mechanic's lien.

[3] Toledo, D. & B. R. Co. *v.* Hamilton (1889), 134 U. S. 296; s. c. 10 Sup. Ct. Rep. 546. Upon the authority of this case the Circuit Court of Appeals lately held, without any argument, that an existing mortgage on a railroad cannot be displaced by a lien for street improvements arising out of a later contract. Pensacola Provisional Municipality *v.* Northrop (1895), 66 Fed. Rep. 689. Compare also Arbuckle *v.* Illinois Midland Ry. Co. *et al.* (1876), 81 Ill. 429.

ing judgments against railroad companies for personal injuries liens as of the date when the cause of action arose prior to any mortgage.[1]

§ 251. **General Lien Laws, how far applicable to Railroads.** — If no special law relating to railroad companies has been enacted for the benefit of laborers and material-men, it will be a question whether the general law on the subject is applicable or not to railroads.[2]

If it is not so applicable, claims for labor done in the construction of the road subsequently to the execution of the mortgage must be postponed to the mortgage debt, even though the claimants have filed a lien in accordance with the provisions of the statute before the mortgage was registered.[3]

Claimants who rely upon these statutes must show that their debts were contracted for labor furnished or materials used in the actual construction of the road, and not merely in its operation.[4]

If the statute, as in Iowa, gives a lien in general terms, it dates from the commencement of the building of the railway, and is prior to a mortgage executed at any time during its construction, even though it may have been executed before the particular piece of work was done for which the lien is claimed.[5] Under such a statute the lien attaches to the whole road; and this rule is not affected by the fact that the claimant has done work only on one division after the other was finished, and under a distinct contract with the company made after such completion.[6]

[1] Phinizy *v.* Augusta & K. R. Co. (1894), 63 Fed. Rep. 922.

[2] The rulings vary in the different States. The note in 20 Am. & Eng. R. R. Cas. 502–506 cites a large number of authorities on questions raised by the filing of mechanics' liens on railroad property. See Larsen *v.* Nelson & Fort Sheppard Ry. Co. (1895), 4 Br. Col. Rep. 151; State *ex rel.* *v.* Recorder of Mortgages, 28 La. Ann. 534; Farmers' Loan & Trust Co. *v.* Can. & St. Louis R. Co., 127 Ind. 250; Bear *v.* Burl., C. R. & M. R. Co., 48 Iowa, 619; Kilpatrick *v.* Kansas City & B. R. Co., 38 Nebr. 620.

[3] Tommey *v.* Spartanburg & Asheville R. Co. (1881), 4 Hughes, 640, construing the law of North Carolina.

A Connecticut law giving mechanics a lien upon buildings for work done and materials furnished in their erection has been held applicable to the buildings of railroad companies as well as those of individuals. Botsford *v.* New Haven, Middletown, & Willimantic R. Co. (1874), 41 Conn. 454, explaining Benedict *v.* Danbury & Norwalk Railroad (1856), 24 Conn. 320. The Kansas Rev. Stats. of 1868 have, it is held, repealed a provision in an earlier act authorizing a mechanic's lien on a railroad. Burgess *v.* Memphis, etc. R. Co. (1877), 18 Kan. 53.

[4] Central Trust Co. *v.* Texas & St. Louis Ry. Co. (Waters Pierce Oil Co., Intervener), (1885), 23 Fed. Rep. 703; Central Trust Co. *v.* Texas & St. Louis Ry. Co. (Borden, Intervener), (1886), 27 Fed. Rep. 178.

[5] Taylor *v.* Burlington, C. R. & M. R. Co. (1877), 4 Dill. 570.

[6] Brooks *v.* Railway Co. (1879), 101 U. S. 443. It was contended that the circumstance of the road in question having been built in sections was enough to distinguish this case from Neilson *v.* Iowa

In Missouri a like conclusion has been arrived at.[1]

On the other hand, the lien under such a statute will be deemed subordinate to the mortgage, if it is claimed for work done on a completed road; as, for instance, to replace a bridge.[2]

A distinction, however, has been taken between those cases in which it is optional for the mortgagee to incur the future liabilities secured by the mortgage, and those in which the mortgagee, at the time the mortgage is executed, enters into a valid contract to incur expenses in connection with the property. In the latter case it has been held that a mortgage of after-acquired property will take precedence of a mechanic's lien for materials furnished after the deed was recorded.[3]

Eastern Co. (1876), 44 Iowa, 71, where the Supreme Court of the State had held that where the construction of the road was continuously carried on, though under different contracts, it was an entire "improvement" within the meaning of the statute, and that the whole property was therefore subject to the lien of persons who did work under the later contracts. This contention was rejected by the court as extremely technical, and the principle laid down that where a road is in every other respect but that of its construction an entirety, that circumstance will not be sufficient to prevent the lien from attaching to the whole road. It was also pointed out that the mortgagees, upon any other theory than that of the entirety of such a road, could only claim a lien on the first few miles of the line, and that it was not easy to see how the road could be one for the purposes of the mortgage, and several pieces of road for the purposes of the mechanics. The case of Canal Co. *v.* Gordon (1867), 6 Wall. 561, relied on by the mortgagees, differed in the essential point that the first section of the canal had been finished and in operation for a considerable time before work on the second section was begun, and for aught that appeared in the report of the case the resumption of work was an afterthought. This construction of the Iowa statute was adhered to in Meyer *v.* Hornby (1879), 101 U. S. 728.

[1] Knapp *v.* St. Louis, Kansas City, & Northern Ry. Co. (1881), 74 Mo. 374; s. c. 7 Am. & Eng. R. R. Cas. 394. Compare Cranston *v.* Union Trust Co. (1881), 75 Mo. 29; s. c. 11 Am. & Eng. R. R. Cas. 638. In the first of these cases it was remarked that although in foreclosing such a lien the whole road must be sold, if sold at all, only so much of the rolling-stock and other movable property as is necessary to satisfy the lien need be sold, if it is elected to proceed against that part of the property.

[2] Taylor *v.* Burlington, C. R. & M. Ry. Co. (1877), 4 Dill. 570.

[3] Neilson *v.* Iowa Eastern R. Co. (1875), 8 Am. Ry. Rep. 82. Here the bonds were issued to a contractor in part payment for the building and equipment of the road. Subsequent to the issuing and recording of the mortgage, and when the contractor had expended a large sum of money in pursuance of his contract, but before the issue of the bonds, material-men acquired a lien for ties. Under these circumstances it was held that the material-man was in no better position than a second mortgagee would have been, if he had taken his security before the negotiation of the bonds secured by the first mortgage. It was further held that sect. 1855 of the Iowa Code, giving material-men a specific lien upon a building in preference to prior liens, did not apply to a case like the one in question, where the specific property, when it comes into the hands of the mortgagor, is so incorporated with the other mortgaged property that it cannot be removed without a destruction of the whole. This case was reheard (see 44 Iowa, 71) upon a different theory, put forward by the claimant. Instead of relying on the rule that after-acquired property is subject to the liens attaching to it when it comes into the possession of the mortgagor, and seeking to have the lien established against

The rule under the lien law of the State of Washington, as determined by the State courts and followed in the Federal courts, is that a material-man who furnishes materials for the construction of a street railway can obtain no lien upon the structure in the streets of a city; nor can he have a lien upon the power-house and land for furnishing materials for the construction of tracks and conduit for a cable road.[1]

The Florida act of June 3, 1887, gave a lien to any person performing any labor upon or for the benefit of any railroad. In a revision of the statutes of the State approved June 8, 1891, the commissioners, in section 1727, provided that any person performing by himself or others any labor upon any railroad should have a lien upon the property of the road. These statutes have been construed to give a contractor a lien upon the road as against a mortgagee of its property.[2]

It was contended in a Colorado case that the trust deed given by a canal company of all its rights, franchises, ditches, flumes, reservoirs, etc., which thereafter it might acquire, whether the same were then or thereafter to be constructed, was prior to the liens of sub-contractors for materials and labor in constructing, after the mortgage was given, a flume across a stream on the line of the right of way. Upon the general principle that a corporation under such circumstances takes the property after acquired *cum onere*, the liens of the sub-contractor were held to be prior to the trust deed.[3]

§ 252. **Waiver of Mechanic's Lien.** — A statement in a contract between a railroad company and a contractor that the latter is to be paid out of a certain fund, — the subscription of a particular county along the line, — is not such an acceptance of collateral security by the contractor as will vitiate his lien. Such a promise does not constitute an equitable assignment of the fund, and gives the contractor no power to collect the money for himself.[4]

the materials actually furnished, he contended that his claim fell under the statutory provision that a mechanic's lien should have priority over a mortgage executed upon the land and the building or improvement, after the commencement of the building or improvement. It was held that the word "improvement" here meant the road as a whole, and not the ties, and the plaintiff's claim was, upon this ground, declared to have the priority as against the mortgage. But the general principle laid down in the first decision was not impugned.

[1] Pacific Rolling Mills Co. *v.* James Street Construction Co. (1895), 68 Fed. Rep. 966; s. c. 16 C. C. A. 68.

[2] Cooper *et al.* *v.* Gaboury *et al.* (1895), 69 Fed. Rep. 7; s. c. 16 C. C. A. 112.

[3] Jarvis *et al.* *v.* State Bank of Ft. Morgan *et al.* (Colo., 1896), 45 Pac. Rep. 505, on authority of Williamson *v.* Railroad Co., 28 N. J. Eq. 277; 29 N. J. Eq. 311; U. S. *v.* New Orleans R. Co., 12 Wall. 362; Hall *v.* Mill Co., 16 Mo. App. 454.

[4] Meyer *v.* Construction Co. (1879), 100 U. S. 457; s. c. 21 Am. Ry. Rep. 465.

In Iowa, where the taking of collateral security is a waiver of a mechanic's lien, it has been held that the taking of bonds secured by a divisional mortgage does not operate as such a waiver, inasmuch as the lien extends to the whole line, a distinct thing from the one division the bonds of which are taken.[1]

§ 253. **Statutes creating Mechanics' and Laborers' Liens are strictly construed.** — These statutes being in derogation of the right of the general creditors to be placed on an equality as regards the payment of their debts, and in the distribution of the earnings and the proceeds of a foreclosure sale, priority will be granted only to the laborers and material-men who have perfected their liens according to the technical requirements of the law.[2] Thus if the lien is given on the property of a railroad in its entirety, it can be secured only by filing the account in the proper clerk's office of every county or municipal corporation through which the road passes.[3]

So also, where a statute gives all "laborers" in the employ of a corporation which becomes insolvent a lien upon the corporate assets, this word will be restricted to the persons who actually perform labor or services, and cannot be construed so as to embrace one who furnishes the labor or services of others, under a contract to do the whole of a particular branch of the business of the corporation.[4]

So also the failure to sue on a contractor's lien within twelve months, such being the requirement of the statute, has been held to be fatal to the vitality of the lien.[5]

But if the claim is on an open and current account for materials furnished, the material-man will be entitled to a lien for the whole amount due, if the last item accrued subsequently to the time within which a lien could be filed.[6]

In some States the rule of strict construction has been held to

[1] Hale, Ayer, & Co. *v.* Burlington, C. R. & N. R. Co. (1881), 13 Fed. Rep. 203.

[2] Jessup *v.* Atlantic & Gulf R. Co. (1879), 3 Woods, 441.

[3] Boston & Co. *v.* Chesapeake & Ohio R. Co. (1882), 76 Va. 180. In this case the claimants also asserted that, even if they had no lien under the statute, they had an equitable priority over the mortgagees; but this contention was rejected by the court on the ground that the materials were furnished, not for *maintenance*, but for *construction* purposes, and also on the technical ground that the lien was first suggested in argument and not in the record.

[4] Lehigh Coal & Navigation Co. *v.* Central R. Co. of New Jersey (1878), 29 N. J. Eq. 252; s. c. 18 Am. Ry. Rep. 207; s. p. Delaware, Lackawanna, & Western R. Co. *v.* Oxford Iron Co. (1880), 33 N. J. Eq. 192; s. c. 1 Am. & Eng. R. R. Cas. 205.

[5] Cherry *v.* North & South R. Co. (1880), 65 Ga. 633; 11 Am. & Eng. R. R. Cas. 636.

[6] Central Trust Co. *v.* Tex. & St. Louis R. Co. (Camden Lumber Co., Intervener), (1885), 23 Fed. Rep. 673.

exclude a sub-contractor of a sub-contractor from the benefit of an act creating a mechanic's lien in favor of a sub-contractor.[1]

But elsewhere such statutes have been construed so as to include sub-contractors.[2]

§ 254. **No Lien obtainable by Contractor except in the Manner prescribed by the Statute.** — A contractor who has secured a statutory lien on a road, but failed to enforce it in the manner prescribed, cannot abandon that lien, and fall back on an alleged equitable lien arising out of the same state of facts, and thereby defeat or postpone an earlier mortgage on the property.[3]

So where a contractor is working under an agreement with a construction company, and not with the railroad company itself, and there is no stipulation that he shall be paid out of the bonds to be issued to the construction company as the work progresses, a mere money judgment obtained by him against the company will not be recognized in a suit to enforce the bonds, except as a lien inferior to that of the bonds.[4]

§ 255. **Bondholders, when not bound by Proceedings under these Statutes unless Parties thereto.** — A proceeding under a statute giving labor claims a priority of lien upon railroad property, and requiring the court having jurisdiction of the cause to render judgment for the amount of wages found to be due, and to order the railroad, or so much of it as may be necessary, to be sold to satisfy the judgment, is not, it has been held, a proceeding *in rem*, there being no provision in the enactment for giving to adverse claimants notice by some form of publication or advertisement. A judgment rendered in such a proceeding is, therefore, not binding upon the trustees or the bondholders unless they were actually parties thereto. This result is not altered by the fact that the statute declares that, in the suits authorized by it, the plaintiff need not make the other lienholders parties, but that such lien-

[1] Rothgerber *v.* Dupuy (1872), 64 Ill. 452; Ahern *v.* Evans (1872), 66 Ill. 125; Arbuckle *v.* Illinois Midland Ry. Co. (1876), 81 Ill. 429. The statute under review in these cases gave a lien for materials "furnished by contract with the company."

[2] Peters *v.* St. Louis & Iron Mountain R. Co. (1857), 24 Mo. 586; Kent *v.* New York Central R. Co. (1855), 12 N. Y. 628; Redmond *v.* Galena & Southern Wisconsin R. Co. (1876), 39 Wis. 426.

[3] Farmers' Loan & Trust Co. *v.* Candler (1893), 92 Ga. 249; s. c. 18 S. E. Rep. 540. The court declined to inquire whether, in the absence of the statute, the contractor would have had any superior equity on the fund produced by the foreclosure sale, merely deciding that it was the clear intention of the legislature that the contractor should be restricted to his statutory lien. That he could have no equitable claim paramount to the mortgagee, on the ground of his having supplied the materials for the road, is also clear from the authorities, see Chap. XXVIII., *post* (preferential debts).

[4] Coe *v.* East & West R. Co. of Alabama (1892), 52 Fed. Rep. 531.

holders may intervene and have their rights adjusted. Not being obliged to intervene, they have a right to come into a court of concurrent jurisdiction, and compel any plaintiff whose claim originated after the mortgage was made to prove affirmatively the existence and priority of his lien under the provisions of the statute.[1]

§ 256. **Stockholder in Construction Company which floats and guaranties Bonds, entitled to claim a Lien.** — The fact that a contractor is a stockholder in a construction company which places the bonds upon the market, and guaranties that sufficient money will be forthcoming from local subscriptions and grants to prepare the road for the reception of the rails, will not estop him from setting up his lien against the mortgage. The remedy for the breach of such a guaranty is against the company as such, and not against an individual stockholder who had nothing to do with giving it.[2]

§ 257. **Statutes declaring Liens in Favor of Debts arising from the Operation of the Road, Effect of.** — In Tennessee an act declares that "no railway company shall have power to execute a mortgage which shall be binding against decrees and judgments" for material and work, or for damages to person or property, in the operation of the road. A lien obtained under this act is binding on the road in the hands of the purchasers.[3]

But a sub-contractor cannot avail himself of its provisions, owing to the peculiar nature of the remedies to which he is confined by the statute defining his rights in Tennessee.[4]

The act, it is held, does not violate the contract of the State with the company.[5]

In North Carolina the statutory priority of certain claims depends on two sections of the Code, — 685, 1255. The first of these provides that a mortgage (or other conveyance) shall be "void" as to existing creditors, and as to torts committed by the company prior to or at the time of the execution of the deed, provided the action to enforce the claim is commenced within sixty days after its registration. The second declares that mortgages shall not have power to exempt the property or earnings of the corporation from executions on judgments obtained for labor or materials or torts. It has been held that the beneficial pro-

[1] Hassall *v.* Wilcox (1890), 130 U. S. 493; s. c. 9 Sup. Ct. Rep. 490; 40 Am. & Eng. R. R. Cas. 385, construing Tex. Gen. Laws, § 79, ch. 12.

[2] Meyer *v.* Hornby (1879), 101 U. S. 728.

[3] Frazier *v.* East Tenn., Va. & Ga. R. Co. (1889), 88 Tenn. 138; s. c. 12 S. W. Rep. 537; 40 Am. & Eng. R. R. Cas. 358.

[4] Central Trust Co. *v.* Bridges (1893), 6 C. C. A. 539; s. c. 57 Fed. Rep. 753; 51 Am. & Eng. R. R. Cas. 452.

[5] Frazier *v.* East Tennessee, Va. & Ga. R. Co. (1889), 88 Tenn. 138; s. c. 12 S. W. Rep. 537; 40 Am. & Eng. R. R. Cas. 358.

visions of the second section are applicable to *all* claims of the specified classes, whether accruing before or after the execution of the mortgage, and are not limited by the proviso in the former section as to the time for beginning suit.[1]

§ 257 *a*. **Priorities in the Case of English Debentures.** — The cases cited in the note below illustrate questions of priorities between debenture-holders and others.[2]

[1] Boston Safe Deposit & Trust Co. *v.* Hudson (C. C. A. 1895), 68 Fed. Rep. 758, affirming Finance Co. of Pennsylvania *v.* Charleston, C. & C. R. Co., *Ex parte* Hudson (1894), 61 Fed. Rep. 369. The opinion in the Court of Appeals contains a review of the decisions on this statute in the Supreme Court of North Carolina.

As to liens having priority to mortgage, see the following English cases: Russell *v.* East Anglian Ry. Co., 3 McN. & G. 125; Imperial Merc. Credit Assn. *v.* Newry & Armagh Ry. Co., I. R. 2 Eq. 524. Judgment creditors subordinate to mortgagees: Potts *v.* Warwick & Birm. Canal Nav. Co., Kay, 142; Ames *v.* Trustees of Birkenhead Docks, 20 Beav. 332; Lord Crewe *v.* Edleston, 1 De G. & J. 93; Legg *v.* Mathieson, 29 L. J. Ch. 385; 2 Giff. 71; Furness *v.* Caterham Ry. Co., 25 Beav. 614; Harrison *v.* Cornwall Minerals R. Co., L. R. 18 Ch. Div. 334.

Cases involving priorities in general: Phelps *v.* St. Catharine's & N. C. R. Co., 19 Ont. 501; Pittsburg, C. & St. L. R. Co. *v.* Marshall, 85 Pa. St. 187; Thomas *v.* N. Y. & G. L. R. Co., 54 N. Y. St. Rep. 498; Pettibone *v.* Tol., C. & St. L. R. Co., 148 Mass. 411; Br. & Alb. R. Co. *v.* Hughes, 52 Ga. 557; Ream *v.* Stone, 102 Ill. 359; Des Moines & Fort Dodge R. Co. *v.* Wat., St. L. & Pac. R. Co., 135 U. S. 576; Balt. & L. Turnpike Co. *v.* Moale, 71 Md. 359; Manhattan Trust Co. *v.* Seattle Coal Co. (1897), 48 Pac. Rep. 333.

[2] As between *general creditors* and debenture-holders on the winding up of the company, see *In re* Opera, Limited (1891), 39 Wkly. Rep. 705; *In re* Standard Manufacturing Company (1891), 1 Ch. D. 627; *In re* General South American Company (1876), 2 Ch. D. 337; *In re* Pyle Works (1889), 44 Ch. D. 534; *In re* The Anglo-American Leather Cloth Company, Limited (1880), 42 L. T. R. 504–507; *In re* Crumlin Viaduct Works Company (1879), 11 Ch. D. 755; *In re* Underbank Mills Company (1885), 31 Ch. D. 226; Gorringe *v.* Irwell India Rubber, etc. Company (1886), 34 Ch. D. 128. As between *judgment or execution creditors* and debenture-holders on the winding up of the company, *In re* Opera, Limited, *supra*; *In re* Standard Manufacturing Co., *supra*; *In re* General South American Co., *supra*; Taunton *v.* Warwickshire Sheriff (1895), 1 Ch. 734; *In re* Bell (1886), 34 Wkly. Rep. 363. Holding that the debenture-holders have priority only as to the "undertaking," meaning the company as a going concern, not upon the surplus lands, as against judgment creditors who have by their diligence obtained a specific right to the proceeds of the sale, *In re* Hull (1888), 40 Ch. Div. 127. As between *trustee of debenture-holders'* deed, and the debenture-holders themselves, holding that the trustee has priority in respect of liabilities incurred by him, *In re* Exhall Coal Company, Limited (1866), 35 Beav. 449. As between holders of debentures of different dates of issue, Sadler *v.* Worley (1894), 8 R. 194; *In re* Mersey Railway Co. (1895), 2 Ch. 287. Debentures treated as valid on question of priorities though irregularly issued, *In re* Queensland Land & Coal Company, Limited (1894), 8 R. 476; Davies *v.* Bolton & Co. (1894), 8 R. 685. Priority of receiver of a company as to moneys raised under court's authority, Greenwood *v.* Algeciras Railway (1894), 7 R. 620. As to priority of debentures issued after, first, default in payment of interest, and, second, the appointment of a receiver, Government Stock Railway Co. *v.* Manila Railway (1895), 2 Ch. 551, affirmed L. R. App. Cases (1897), 2 Ch. p. 81, holding that the debenture-holders have a lien.

CHAPTER XII.

TRUSTEES.

Article I. — Creation and Termination of the Trust. Appointment and Removal of Trustees.[1]

§ 258. **The Selection of the Trustee.** — "The salability of railroad bonds depends, in no inconsiderable degree, upon the character of the persons who are selected to manage the trust. If these persons are of well-known integrity and pecuniary ability, the bonds are more readily sold than if this were not the case. It is natural that it should be so, and on this account the trustees usually appointed in this class of mortgages are persons of good reputations in the cities where the bonds are likely to sell." [2]

A railroad mortgage confers upon the designated trustees specific powers which, although dormant as long as the mortgagor is solvent, may, by the occurrence of a default or some conduct which threatens the interests of the bondholders, demand the performance of duties of a very delicate and onerous nature. It is true that the question whether, under all the circumstances of the case, it is for the advantage of the *cestuis que trustent* that the trustees should assume control of the mortgaged property, is generally, by the express terms of the instrument, a matter to be determined by a certain portion of the bondholders. Usually, however, the bondholders are so widely scattered, and possess such a slender acquaintance with the facts requisite to enable

[1] As to the extent to which bondholders are bound by the action of a trustee in litigation affecting their rights, see Parties, Chap. XXIV. On the duty of a trustee to countersign and deliver bonds, see Chap. I.

[2] Knapp *v.* Railroad Co. (1874), 20 Wall. 117; s. c. 22 L. Coöp. ed. 328. Compare Merrill *v.* Farmers' Loan & Trust Co. (1881), 24 Hun, 297, where the court says: "In trusts of this nature responsible and intelligent parties are commonly selected to receive them, for the purpose of assuring the creditors that they will be faithfully executed for their benefit, and their interests in the property protected, as far as that can be done by fidelity and attention on the part of the trustee."

them to arrive at a correct decision, that, for practical purposes, the opinion of the trustees in regard to the propriety of such a step is often apt to be of great, if not controlling, weight; and the effect of this restrictive provision will probably be, that in most cases the selection of the course to be adopted will be as much in their hands as if no such limitation had been placed upon their authority. In view of these considerations, it seems clear that good administrative capacity, and a knowledge of the details of railroad business in general, and of the business of the mortgagor company in particular, if possible, are qualifications quite as necessary for a trustee as financial ability. In the early history of railroad securities, natural persons were quite commonly chosen as trustees. In such cases, however, troublesome questions will arise as to filling of vacancies in case of death.

Besides this, the difficulty of finding individuals possessing the manifold qualifications required in the depositary of a trust of this description has latterly led more and more to the selection of corporations which, as they control a large capital and make a specialty of this class of business, possess in a far higher degree both the financial standing which will inspire confidence in investors, and the experience and skill which will enable them to manage the trust estate to the best advantage, if it should become necessary to enter into possession.

§ 259. **Legal Capacity of Individuals and Corporations to be Trustees.** — (a) *The general rule* on this subject has been thus stated by a well-known text writer in words which are as applicable to the trustees of a railroad mortgage as to others: "Whoever is capable of taking the legal title or beneficial interest in property may take the same trust for others. Whatever persons or corporations are capable of having the legal title or beneficial interest cast upon them by gift, grant, bequest, or operation of law, may take the same subject to a trust, and they will become trustees. But it does not follow that whoever is capable of taking in trust is capable of performing or executing it. The inquiry, then, is not so much, who may take in trust, as it is, who may execute and perform a trust."[1]

The principles here formulated are applied without qualification where the proposed trustee resides in the State in which the property to be mortgaged is situated. The capacity to accept the trust is decided, in the case of natural persons, by the law of the State applicable in such case, and as to corporations, by the terms of their charters or general statutes under which they are organ-

[1] Perry on Trustees, § 39.

ized, and the law of the State applicable to trusts. On the other hand, where the domicil of the trustee and the *situs* of the property are in different States, it becomes necessary to consider whether this circumstance creates any partial or complete incapacity under the laws of either State. If the ownership of bonds to a certain amount be a necessary qualification under the mortgage, a candidate for the office is not rendered ineligible for the reason that he acquired bonds to that amount expressly for the purpose of making himself eligible; nor will a sale of the bonds after his election disqualify such a trustee for continuing to perform the duties of the office.[1]

(b) *Non-residence of Natural Person.*—It is apparently well settled that no disqualification on the ground of non-residence will be inferred merely on grounds of public policy. Thus where a trust deed, by implication, required the trustees to be residents of another State, the court, while waiving the inquiry whether public policy, even in the most narrow sense, would be promoted by limiting the right to control and manage railroads to residents of the State in which the railroad was situated, said that it was very clear that the provision was not against public policy in any such sense as would affect the validity of the contract. The stipulation was merely an innocent provision made to answer the convenience of the parties, and one which, in the absence of any legislation forbidding it, they were at perfect liberty to make.[2]

Positive legislation on this subject is necessarily circumscribed by the constitutional provision which declares that "the citizens of each State shall be entitled to all the privileges and immunities of citizens of the several States." An Indiana act, therefore, which declared non-residents to be incapable of acting as trustees has been held invalid, so far as regards citizens of the United States, since they cannot be denied the right to take and hold absolutely real or personal property in any State of the Union, or to accept the conveyance of such property in trust for their sole benefit, or for the benefit of themselves and others.[3]

[1] Richards *v.* Merrimack & Connecticut River Railroad (1862), 44 N. H. 127. The trust relationship may be created without a designation of the mortgagee as trustee. Thus where a mortgage on railroad property is executed to an individual and his assigns (and not to him as trustee), who may subsequently become holders of bonds to be issued to him by the railroad company, should he assign any such bonds, he will be treated under the mortgage as trustee for the holders of the bonds. *In re* Bondholders of York & C. R. Co. (1861), 50 Me. 552; Mason *v.* York & C. R. Co. (1861), 52 Me. 82.

[2] Cheever *v.* Rutland, Burlington, & W. R. Co. (1869), 4 Am. Ry. Rep. 291.

[3] Farmers' Loan & Trust Co. *v.* Chicago & A. R. Co. (1886), 27 Fed. Rep. 146; s. c. 24 Am. & Eng. R. R. Cas. 66.

(c) *Foreign Corporations as Trustees.* — In this subdivision we consider the position of a corporation which is foreign to the State where the property is situated. The subject must, then, be considered, first, from the point of view whether the corporation can by the law of the State to which it belongs take a trust of property in another State; and, secondly, whether it can do so under the law of the foreign State where the property is situated. The statutes of both States must be considered. It is the general law throughout the United States that foreign corporations can become trustees of railroad mortgages, — "foreign," for the purpose of this rule, meaning foreign to the particular State of the United States where the property is situated. An entirely different case is presented where the corporation is organized under laws of a State other than one of the United States. The laws against aliens holding lands are generally such as to prevent such corporations from becoming trustees. As respects corporations, the constitutional provision in (b), *supra*, has no application.

Presumably, therefore, an act invalidating all trust deeds executed to foreign corporations would be unobjectionable on constitutional grounds.[1]

The limitations on the powers of foreign corporations, however, so far as they concern the present discussion, have been considered chiefly in relation to the common provision, statutory or constitutional, which prohibits such corporations from "doing business" in a State, except on certain conditions.

The mere acceptance of a trust which is to be executed afterwards on a contingency is probably not within the prohibition.[2]

A trust mortgage to secure a debt is not within the prohibition

[1] This was assumed in Farmers' Loan & Trust Co. *v.* Chicago & A. Ry. Co., *supra;* but Judge Gresham, upon a review of the wording of the statute, concluded that it could not have been intended to apply to corporations. But on the point as to public policy referred to *supra*, a similar ruling has been made in regard to foreign corporations by Mr. Justice Harlan, of the Supreme Court of the United States. Hervey *v.* Illinois Midland Ry. Co. (1884), 28 Fed. Rep. 169, 175. This point was not noticed on the appeal. See Union Trust Co. *v.* Illinois Midland Ry. Co. (1886), 117 U. S. 434.

[2] American Loan & Trust Co. *v.* East & West R. Co. of Alabama (1889), 37 Fed. Rep. 242. The court expressed an independent opinion to the effect stated in the text, but based its actual decision that the trust deed to the foreign corporation was voidable merely, and not void, upon the case of Sherwood *v.* Alvis (1887), 83 Ala. 115; s. c. 3 Am. St. Rep. 695. This case, as explained in the subsequent decision of Dudley *v.* Collier (1888), 87 Ala. 431, cannot be regarded as an authority for the point to which it was cited. This and other rulings of the same court have established the doctrine in that State that even the single act of making one loan of money, and taking a mortgage to secure it, by a foreign company engaged in the business of lending money on mortgages, is "doing business." See Thompson on Corp., §§ 7955, 7957.

of the Illinois act of June 15, 1887, as amended by the act of June 1, 1889, declaring a trust unlawful where it is taken by a corporation organized for the purpose of accepting and executing trusts, unless the corporation has made a certain deposit for the benefit of its creditors.[1]

Even if such a statute should disable the trustee from executing the trust, it cannot have the effect of preventing the bondholders from enforcing it in a federal court.[2]

The questions above considered present themselves in a somewhat different aspect, when the power of a trust company to take a mortgage of the property of a foreign railroad is disputed in one of the courts of the State in which the company was organized. The true principle seems to be that the grant of a charter to do business of the kind for which such corporations are organized will not, in the absence of some express limitation, be deemed to refer merely to those cases in which the subject-matter of the pledge is situated in the State by which the charter was granted.[3]

[1] Farmers' Loan & Trust Co. *v.* Chicago P. & N. R. Co. (1895), 68 Fed. Rep. 412.

[2] Farmers' Loan & Trust Co. *v.* Chicago & N. P. R. Co. (1895), 68 Fed. Rep. 412. Judge Jenkins said: "It may be that certain trusts contained in the trust deed or mortgage cannot be enforced by the trustee while in contempt of, and until compliance with, the laws of the State of Illinois. I refer to those provisions of the instrument which authorize the trustee to take possession of, acquire title to, and convey the property. It is not, however, necessary, nor by this bill is it sought, to execute those trusts. If they are void, their invalidity does not necessarily invalidate the instrument as a mortgage. The court will treat it as a mortgage merely, the trustee, as mortgagee, holding the naked legal title to the security, the bondholders being the beneficial owners. The court will enforce the security by judicial sale, not permitting the execution of any trust that may be inoperative until compliance with the law of the State of Illinois. The statute has provided a penalty for the act of the trustee, if its assumption of duty is within the prohibition of the act. That penalty is the measure of punishment which the State saw fit to impose for violation of its laws. It has not undertaken to render void the trust deed or mortgage, or to deny to innocent parties the enforcement of it in protection of their rights. It may be that the courts of the State of Illinois would refuse to recognize the trustee standing in defiance of its laws. I do not think, however, that the duty is imposed upon a federal court to punish innocent parties in vindication of the authority of the State."

The Farmers' Loan & Trust Co., in a late action in the Superior Court of Cook County, Illinois, has been removed from the trusteeship of a deed of trust made by a street-railroad company, on the ground that it had not complied with the requirements of the law of the State of Illinois as to a deposit of securities by foreign corporations doing business within the State. The decree of the lower court was affirmed by the appellate court for that district in February, 1897.

In American Loan & Trust Co. *v.* East & West Railroad Co. (1889), 37 Fed. Rep. 242, it was strongly intimated that a statute of this character would debar a trustee corporation which had not complied with the laws from interfering actively in the enforcement of the trust.

[3] Farmers' Loan & Trust Co. *v.* Harmony Ins. Co. (1868), 51 Barb. 33. The doctrine stated in the text is not explicitly enunciated in this case, but seems to be fairly deducible from the ruling and the language of the court.

§ 260. **A State may be a Trustee.**[1] — This relation to the bondholders is sometimes the result of the express language of the acts by which State aid is granted for carrying out works of internal improvement by the exchange of State for railroad bonds. Under these circumstances the lien usually created by these statutes to indemnify the State for the loan of its credit is for the benefit of the holders of the State bonds, and the State is the instrument through which the liability of the company to the bondholder is to be discharged.[2]

In such a case no special mortgage is required to fasten the lien upon the property, or to put the State in the position of a trustee.[3] The State does not, however, become a trustee merely by indorsing the bonds and declaring a lien upon the company's property for its own protection. Under such circumstances, therefore, the purchase by the State of that property, in order to secure itself, is not invalid, and the transaction will not be set aside at the suit of a bondholder.[4]

Nor does the State assume the position of a trustee by hypothecating, as a security for a certain issue of bonds, the stock of the company which it holds by virtue of an act allowing it to subscribe for the shares, and giving it the right to appoint a majority of the directors. In such a case there is no implied agreement to charge itself with the duty of exercising its powers of control so as to preserve the earnings of the road, and appropriate them to the payment of the bonds. The State is no more a trustee than any other majority stockholder of a corporation, and is under no duty to the mortgagee except to conduct itself honestly in exerting its powers of control for the interests of the mortgagees and other creditors and stockholders of the corporation.[5]

§ 261. **Resignation of Trustee.** — A trustee, after he has accepted the office, cannot discharge himself by a subsequent resignation merely, or by his own act. He must be discharged either by virtue of some special provision in the trust deed, or by an order of some court of competent jurisdiction, or by the consent of all persons interested.[6]

§ 262. **Appointment, Removal, and Substitution of Trustees by a Court of Chancery, generally.** — The inherent authority of equity

[1] Perry on Trusts, § 41.

[2] Holland *v.* State of Florida (1876), 15 Fla. 455 (see especially p. 534).

[3] State of Florida *v.* Florida Central R. Co. (1876), 15 Fla. 690.

[4] Cunningham *v.* Macon & Brunswick R. Co. (1878), 3 Woods, 418; s. c. 6 Fed. Cas. 974, Case No. 3483.

[5] Gibson *v.* Richmond & Danville R. Co. (1889), 37 Fed. Rep. 743; s. c. 5 Ry. & Corp. L. J. 461.

[6] Richards *v.* Merrimack & Connecticut River Railroad (1862), 44 N. H. 127.

to effectuate a trust extends to the appointment of trustees to administer a statutory trust, although no provision for such an appointment is made by the statute itself.[1]

By the general law of trusts a court of equity has power to remove and appoint trustees, in order that the trust shall survive and be executed so as to effect the purposes for which it is established.[2]

This power is not defeated by the fact that there are special legislative provisions respecting the election of trustees. These are regarded merely as "auxiliary regulations designed to aid the court in the discharge of its duty, and to facilitate the action of the bondholders who may desire to co-operate to secure a more efficient execution of the trust, and are not intended to prohibit an individual bondholder from directly invoking the aid of a court of equity in behalf of himself and others entitled to the protection of the same security.[3]

A court, however, cannot remove trustees from a part of their trust, leaving them burdened with, and responsible for, the remainder.[4]

§ 263. **Grounds for Removal.** — (a) *Non-residents.* — A railroad trustee who becomes a resident of a foreign country is deemed to have thereby incapacitated himself for the duties of the office, and if he attempts thereafter to bring suit as trustee in a Federal court, the State court will enjoin him.[5]

The jurisdiction of a court of chancery to substitute another trustee in such a case may be exercised even though the absent trustee is within the military lines of an enemy, and cannot be served with process. Such a circumstance does not detract from the power of the court to remove him and appoint another, but rather furnishes a good reason for the appointment of a successor.[6]

1 *In re* Eastern Railroad (1876), 120 Mass. 412.

2 Hale *v.* Nashua & Lowell Railroad (1880), 60 N. H. 333.

3 Inhabitants of Anson, Petitioners, etc. (1892), 85 Me. 79; s. c. 26 Atl. Rep. 996. It was also held that the inherent jurisdiction of a court of equity was not, in this case, defeated by the formation of a new corporation by a majority of the bondholders; nor by the foreclosure promoted by the bondholders, the trustees not being parties thereto, and a sale of the equity of redemption on execution to the new corporation; nor by the creation of a new debt, secured by mortgage, for the extension of the road; nor by the fact that a majority of the bonds was represented at the organization of the new corporation, there being nothing in the mortgage authorizing a majority of the bondholders to act for the minority in matters respecting the mortgage.

4 Sturges *v.* Knapp (1858), 31 Vt. 1.

5 Farmers' Loan & Trust Co. *v.* Hughes, 11 Hun, 130. Compare Hughes *v.* Chicago, Milw. & St. Paul Ry. Co. (1881), 47 N. Y. Supr. Ct. 531; 15 J. & S. 531.

6 Ketchum *v.* Mobile & Ohio R. Co. (1876), 2 Woods, 532. Woods, C. J., said: "The war might have lasted twenty years, during all which time it would

Where the trust deed itself provides that, in case the trustee therein named is absent from the State when required to act, another person shall be appointed to succeed him, the clause will be construed as referring to a permanent absence, and not to an absence that is merely casual or temporary.[1]

(b) *Acquisition of Hostile Interests.* — The fact that the trustees have acquired interests hostile to those of the bondholders is a sufficient ground for their removal.[2]

The fact that what is alleged in a petition filed in a Federal court for the removal of trustees was done by them in another capacity and in another relation to the *property*, under the directions of a State court, will not constitute any reason why they should not be removed, where they have come out of those proceedings with such interests in the property that their position is hostile to that of the petitioners.[3]

Whether a trustee who represents several different classes of bondholders secured by successive mortgages is thereby disqualified from acting for more than one of those classes in foreclosure proceedings, is a question which has been answered differently by the two federal circuit judges to whom it has been submitted. In Clyde *v.* Richmond & Danville R. Co.,[4] Judge Goff refused to allow committees of bondholders to become parties on this ground alone,[5] taking the position that it would not be presumed that the trustee would be unfaithful to the trusts confided to him, and that it would be time enough to consider the question whether the bondholders should be made parties for their own protection when the trustee failed promptly and faithfully to discharge his duties.

have been impossible to serve the absent trustee. It seems to me to be a very unreasonable proposition that during all this time a court of chancery must see the trust estate perishing for want of a trustee, and refuse to act on the ground that a naked trustee, whom it was impossible to serve, had not been served with process." In this case there was the additional circumstance that the trustee had made no claim to the office for ten years after the war. The court held that, even if without notice, the appointment of another trustee was good for temporary purposes only, and the power of the court extended that far, undoubtedly; also that the trustee who had been removed had lost his right to resume his office by his long acquiescence. This case may be contrasted with that of Washington, Alexandria, & Georgetown R. Co. *v.* Alexandria & Washington R. Co. (1870), 19 Gratt. (Va.) 592, cited in § 264, *post*, where the trust deed required notice of the application for a new trustee to be given to certain officers of the corporation.

[1] Equitable Trust Co. *v.* Fisher (1883), 106 Ill. 189.

[2] Dwight *v.* Smith (1882), 13 Fed. Rep. 50. See Perry on Trusts, § 275.

[3] Brooks *v.* Vermont Central R. Co. (1878), 14 Blatch. 463.

[4] 55 Fed. Rep. 445 (1893).

[5] As to the general rule in regard to the intervention of bondholders, see Chap. XXIV. (parties).

In the recent case of Farmers' Loan & Trust Co. *v.* Northern Pacific R. Co.,[1] Judge Lacombe, under similar circumstances, considered that the proper course was either to substitute new trustees under all the mortgages but one, or to allow representative bondholders to become parties to the suit, the latter being the course actually adopted. The action of Judge Goff was referred to with disapproval.

(c) *Breach of Trust.* — If there has been an actual breach of trust on the part of the trustee, the proper remedy of the bondholders is to take appropriate measures to have them removed, and their places filled by others who will perform their duty.[2]

The court, however, will not remove a trustee for every mistake and neglect of duty, but only for such conduct as endangers the trust property, or shows a want of capacity, honesty, or reasonable fidelity.[3]

Thus a trustee under two railroad mortgages should not be removed from his trusteeship, on the application of a majority in interest of the bondholders under the first mortgage, for the reason that he declined to employ counsel selected by them to foreclose their mortgage, and refused to elect under which mortgage he would serve and which he would resign, especially if, for anything that appears, the trustee's judgment in the matter was sound and not against the interest of any bondholders.[4]

On the other hand, it has been held a proper case for the removal of a trustee that he suffered a portion of the bonds to remain unpaid after maturity, and neglected and refused to take possession of the mortgaged property and to execute the trust by enforcing the mortgage on the request of the bondholders. It is a clear violation of the trust to attempt to compel the *cestuis que trustent* to wait the pleasure of the trustee in foreclosing the mortgage, or to coerce them to afford facilities to the debtor to raise means to pay its debts.[5]

A complaint in an action for the removal of a trustee is not demurrable where it alleges that the defendant has refused to obey an order to convey the trust property, made by a competent court, and therefore valid until reversed and vacated.[6]

§ 264. **Mortgage Provisions for filling Vacancies.** — Generally the mode of filling vacancies is governed by the instrument itself.

[1] 70 Fed. Rep. 423 (1895). See also subd. (c), below.

[2] Stevens *v.* Eldridge (1876), 4 Cliff. 348.

[3] Fletcher *v.* Rutland & Burlington R. Co. (1858), 39 Vt. 633.

[4] Beadleston *v.* Knapp (1872), 13 Abb. Pr. N. S. 335.

[5] In the Matter of the Petition of the Mechanics' Bank (1848), 2 Barb. 446.

[6] Harrison *v.* Union Trust Co. (1895), 144 N. Y. 326; s. c. 39 N. E. Rep. 353.

Hence although the mortgagor may, by general rules of law, have the right to be notified of the application to fill a vacancy, an appointment is valid without such notice where the mortgage merely requires nomination by one of the beneficiaries, and approval by a judge of one of the courts of the State.[1]

On the other hand, if such notice is expressly required, and not given, this will invalidate the appointment.[2]

Where the deed provides the mode in which the successors of the original trustees are to be selected, and proceedings are instituted to procure confirmation of an appointment which is asserted to be invalid for the reason that the terms of the deed have not been strictly followed, it is not necessary that every individual bondholder should be notified of such proceedings, the duty of the court being merely to see that service is made upon the grantor and the different beneficiaries under the trust so as to insure a full and fair representation of that interest.[3]

§ 265. **Appointment by the Company itself.** — The company itself may appoint a new trustee, if it has reserved the power to do so;[4] and in such a case the propriety of an appointment to which it has consented cannot be questioned by it, although there may have been no formal resolution on the subject.[5]

§ 266. **Election by the Surviving Trustees.** — Where the trustees themselves are vested with the power of filling vacancies, they cannot do discretionary acts without filling a vacancy. Taking possession of the road, where the deed allows the trustees to do so without any requisition of the bondholders, is an act of that character, and therefore, if one of the trustees dies after the filing of a bill to obtain possession, his place must be supplied by the survivors before the suit can proceed. The corporation can take advantage of the failure to fill the vacancy, for it is uncertain what may be the opinion of the new trustee as to the further prosecution of the suit.[6]

1 Macon & Augusta R. Co. *v.* Georgia Railroad & Bkg. Co. (1879), 63 Ga. 103; s. c. 1 Am. & Eng. R. R. Cas. 378.

2 Washington, Alexandria, & Georgetown R. Co. *v.* Alexandria & Washington R. Co. (1870), 19 Gratt. (Va.) 592. In this case the officers of the company to whom notice of the application to fill a vacancy was to be given were all within the enemy's lines when the vacancy occurred, and for a considerable time thereafter. This is certainly a strict ruling, and, considering the inherent powers of a chancery court in reference to trusts, a doctrine which would rigidly insist upon notice under such circumstances seems to be of very dubious soundness. See § 263, *ante*.

3 Cheever *v.* Rutland & Burlington R. Co. (1869), 4 Am. Ry. Rep. 291 (at p. 305).

4 Fidelity Insurance, Trust, & Safe Deposit Co. *v.* Shenandoah Valley R. Co. (1889), 32 W. Va. 244; s. c. 9 S. E. Rep. 180; 38 Am. & Eng. R. R. Cas. 577.

5 Mobile & Cedar Point R. Co. *v.* Talman (1849), 15 Ala. 472.

6 Shaw *v.* Norfolk County R. Co. (1855), 5 Gray (Mass.), 162, 176.

§ 267. **Statutory Provisions regulating the Manner of the Election of Trustees.** — These have been enacted in some States. Those of Maine have been held to be applicable only when no other method of filling vacancies is prescribed in the mortgage itself or by special law.[1]

The Maine statutes have been held to apply only where the trust, the trustee, and the *cestui que trust* are all created by one and the same deed; and accordingly they did not authorize the parties to whom the grantee named in a mortgage which was executed to him upon his taking a contract for the construction of the road had assigned the bonds secured by the mortgage to elect a substitute for the mortgagee, such a grantee not occupying the position of trustee for the assignees of the bonds.[2]

§ 268. **Statutes respecting the Election of Trustees cannot override the Provisions of a Trust Deed previously executed.** — If, therefore, that instrument specifies the manner in which the trust shall be perpetuated, a statute subsequently enacted which provides for the appointment of trustees annually, in case the railroad is in the possession of and being operated by the trustees, interferes with the vested rights of the trustees, and is therefore repugnant to the constitutional provision which forbids a State legislature from passing any law impairing the obligation of a contract.[3]

Nor can the legislature, without the consent of the *cestui que trust*, substitute a new trustee in place of the persons named in the mortgage. The particular trustees are selected for special reasons, and to change them is to change the contract in an important point.[4]

§ 269. **Termination of the Trust.** — The general rule is that the trust continues until all bonds are paid, unless in the meantime the trustee is discharged.[5]

As long as any bonds are outstanding unmatured, it is the right and duty of the trustee to enforce the provisions of the mortgage for the benefit of the bondholders.[6] Foreclosure does not termi-

[1] Pillsbury *v.* Consolidated European & N. A. Ry. Co. (1879), 69 Me. 394. Here the appointment of a trustee by the court, upon the request of a majority in interest of the bondholders, was sustained on the ground that, as the terms of the trust deed had been followed, the appointment was fully authorized by law.

[2] *In re* Bondholders of York & Cumberland R. Co. (1861), 50 Me. 552.

[3] Fletcher *v.* Rutland & Burlington R. Co. (1858), 39 Vt. 633. This case was decided by Judge Bennett sitting as chancellor, but the decision was concurred in by three judges of the Supreme Court.

[4] Knapp *v.* Railroad Co. (1874), 20 Wall. 117.

[5] Knapp *v.* Railroad Co. (1874), 20 Wall. 117.

[6] Belden *v.* Burke (1883), 72 Hun, 519.

nate the duties of a trustee who has entered into possession. He is still bound to manage the road for the benefit of the *cestuis que trust* just as an experienced owner would, looking to the nature of the property, the public demand upon those in charge, and the duty of securing the greatest permanent return to the *cestuis que trust.* This obligation continues until his discharge by the Court of Chancery, or by the unanimous and legally binding consent of the beneficiaries, or until the latter acquire a legal organization and a capacity to act through a majority.[1]

The appointment of a referee to make a foreclosure sale does not abrogate a trustee's right and duty to enforce by proper remedies a judgment in favor of the bondholders.[2]

The functions of the trustees, on the other hand, cease whenever the trust property is disposed of and applied in accordance with the terms of the trust deed.[3]

It follows, therefore, that a trustee who, under the provisions of an enabling statute, purchases the property at the foreclosure sale, and then transfers it to a company organized from the general body of the bondholders, is thereby divested of his title as trustee, and has no right to maintain a bill to take advantage of alleged frauds or irregularities in the foreclosure of prior liens.[4]

Article II. — Nature and Extent of the Trustee's Estate and Powers.

§ 270. **The Precise Character of the Interest acquired by the Trustee** in the trust property bas given rise to much discussion. It may be readily conceded that, where the trust deed is worded so that defeasance can be made only by payment to the bondholders, the trustees take nothing but a dry, naked trust.[5]

But this can scarcely be the effect of a trust mortgage in the ordinary form. The authority conferred upon the trustee by such an instrument may possibly be regarded as investing him with a

[1] Sturges *v.* Knapp (1858), 31 Vt. 1.

[2] Stevens *v.* Union Trust Co. (1891), 57 Hun, 498; s. c. 33 N. Y. St. Rep. 130; 11 N. Y. Supp. 268.

[3] Welsh *v.* First Division, etc. St. Paul & Pacific R. Co. (1879), 25 Minn. 314.

[4] Barnes *v.* Chicago, Milw. & St. Paul Ry. Co. (1887), 122 U. S. 1; s. c. 7 Sup. Ct. Rep. 1043.

[5] Brooks *v.* Vermont Central R. Co. (1878), 14 Blatch. 463. The position here taken as to the nature of the trustees' interest was one of the steps in the chain of reasoning which led Judge Wheeler to the conclusion that a suit for foreclosure brought by a portion of the bondholders was not barred by a pending suit for the same purpose brought by the trustees and another portion of the bondholders.

merely dry, naked trust at the outset;[1] but potentially, at least, it is one of a much more extensive scope.[2]

This being admitted, it seems an unnecessary refinement to consider the estate of the trustee to be of a different quality at different times. A simpler and more straightforward doctrine is to hold that the nature of the trust is what the trust instrument makes it, and continues the same from first to last, but that the powers and duties of the trustee remain in abeyance until the events occur which are to call them into activity. To take a somewhat analogous case, a tenant in fee is none the less such because he has leased the estate, and has thus abandoned most of his rights over it until the term is ended, or the lessee, by the breach of some condition imposed by the instrument of demise, renders himself liable to be dispossessed. And this seems to be the effect of the cases in which the nature of the trust was the question fairly presented to the court, and it became necessary to determine precisely what the powers of the trustee were. "We are unable," remarked the court in a Vermont case, "to assent to the proposition that the trustees are only agents of the *cestuis que trust* for holding the *legal title*. They are agents for

[1] Curtis *v.* Leavitt (1857), 15 N. Y. 9 (followed in Johnson County *v.* Thayer, 94 U. S. 631). Judge Paige declared the trustee to be a mere assignee without interest in the property held by him, this theory being made the foundation, at least in part, of a ruling that notice to a trustee was not notice to the *cestuis que trust* (see below). In this case the extent of the trustees' powers was not in question, and it is not easy to see how this doctrine can be reconciled with the rule that a trust which is to protect an estate for a given time, to preserve contingent remainders, or the like, is one of those active trusts which are excluded from the operation of the Statute of Uses (see Perry on Trusts, § 305 and notes). In Ketchum *v.* Mobile & Ohio R. Co. (1876), 2 Woods, 532, a trustee was considered to hold a "naked trust" to the extent that his absence and residence in a place where it was impossible to serve him with process would not prevent a court of equity from entertaining a suit for his removal. Here again it was not a question of the trustee's powers, and to have made a different ruling would have involved the anomalous result that non-residence is a legitimate ground for removal, but that the court is disabled from exercising its jurisdiction until service is made on the trustee. So far as it appears from the authorities the power of removal for this cause exists in the case of the most active, as of merely passive trustees (see Perry on Trusts, § 275), and perhaps the phrase "naked trust" is used here merely in the sense of a trust not coupled with an interest, — a somewhat loose application of the term. In Webb *v.* Vermont Central R. Co. (1882), 20 Blatch. 218, the court speaks of the trustees as holding only a "dry legal title;" but the only question before it was as to the ability of the bondholders to sue, when the trustee acquires interests hostile to theirs, and it is not apparent what bearing the character of the trust could have on such a point. The elementary principle that a trustee cannot be allowed to occupy a position in which his interests are opposed to those of his *cestuis que trust* is presumably applicable to every description of trust.

[2] Commonwealth *v.* Susquehanna & Delaware River R. Co. (1888), 122 Pa. St. 306; s. c. 15 Atl. Rep. 448; 36 Am. & Eng. R. R. Cas. 269.

holding just such title as is created by the transaction, and for administering it according to the terms of the trust; and whatever title the *cestuis que trust* have, whether legal or equitable, is through and in virtue of the title conveyed to and held by the trustees."[1]

§ 271. **The Trustee takes an Estate sufficient to enable him to execute his Trust.** — If, therefore, the provisions of the mortgage are such that they cannot be carried out unless the trustee holds in fee simple, he will be deemed to be invested with an estate of that character, although the granting clauses contain no words of inheritance. Thus where he is empowered by the provisions which regulate the sale of the trust property to convey the entire estate of the railroad company in the mortgaged premises, he must be clothed with that entire estate in order to be capable of executing his trust. Of this fact subsequent mortgagees and creditors have notice from the record itself, and, as against them, the mortgage will, if necessary, be reformed so as to make its terms correspond with the intention of the grantor.[2]

In Kentucky also it has been declared that a trustee is not a naked one where he has a power of sale on default.[3]

Trustees of a mortgage covering the lands included in a land-grant to a railroad company, with power to sell them on such

[1] Miller *v.* Rutland & Washington R. Co. (1863), 36 Vt. 452, 483. The reasons for the doctrine here laid down had been thus stated in a case decided not long before by the same court, the opinion being entitled to exceptional respect, as it was written by Chief Justice Redfield: "If the interest on the coupons and the principal, as it falls due, are promptly paid by the corporation, so that no forfeiture occurs, it will never become of sufficient importance to consider the question what is the precise nature of the trust created by the contract in the first instance. But after the forfeiture occurs, either by non-payment of interest or principal, or both, as in the present case, the duties of the trustee become not only active and responsible, but critical and delicate. It is not only not a dead, dry trust, but it is one of the most active and momentous responsibility." The duties thus undertaken, it was held, did not cease with the foreclosure of the mortgage. It was not to be expected that there should be an immediate surrender of the property to the heterogeneous and chaotic mass of men, women (single and married), and infants who composed the body of bondholders. Where so many of the *cestuis que trust* were under such disabilities that they could not act for themselves, and where consequent delay must ensue in providing the means of obtaining their consent in a legal form, with possibly fatal results to the property, it was clearly the duty of the trustees to continue to manage that property for the benefit of those whom they represented, until they could be regularly discharged. The conclusion arrived at was that the trustees, even after foreclosure, had the power to lease the property to a connecting road, if, in the exercise of a sound discretion, they deemed such a contract to be the best way of serving the interests of the *cestuis que trust*, especially where that lease contained a clause allowing the majority of the bondholders to revoke it upon giving a year's notice.

[2] Coe *v.* New Jersey Midland Ry. Co. (1879), 31 N. J. Eq. 105. See generally on this point Perry on Trusts, § 313.

[3] Bardstown & Louisville R. Co. *v.* Metcalfe (1862), 4 Metc. (Ky.) 199.

terms and conditions as they may deem best, are authorized to warrant the title of the lands to purchasers.[1]

§ 272. **Quality of Trustee's Estate, how affected by Statutory Provisions.** — Since the terms of the deed decide the extent and character of the trustee's estate, a general statutory provision as to trusts, that the legal title and right of possession shall vest in trustees, will not have the effect of making the latter the proper parties to prosecute a suit for a trespass upon the trust property.[2]

On the other hand, if there are statutes prescribing the duties of trustees, there is no necessity for specifying those duties in the mortgage for the purpose of fixing the *quantum* of interest taken by them, and the fact that the instrument is silent in this respect is in such a case no ground for contending that the trustees take merely the dry legal title.

§ 273. **Devolution of the Trust Estate.** — Upon the death of one or two or more trustees, the whole estate devolves on the survivors, and not upon the heirs or personal representatives of the deceased trustee.[3]

Such heirs or personal representatives, therefore, are not proper or necessary parties to a foreclosure suit begun during the lifetime of their ancestor.[4]

The question who are the proper parties in case the trustees of a mortgage are all dead, was discussed in Gibert *v.* Washington City, Va. Midl. & Great Southern R. Co.[5] There proceedings were taken to determine the relative priorities of certain claims against a railroad company formed by the consolidation of several others, and the objection was raised that, as the trustees under the several deeds had deceased, the legal title was outstanding, and there was no one before the court to represent the legal title " with respect to this argument." The court said: " It is sufficient to remark that if, on the death of the trustee Lamar, the legal title was in abeyance, that would not defeat the trust, nor prevent the jurisdiction of the court from attaching, in the absence of a representative of the legal title, no such representative being in existence. Indeed, it would be a potent reason for the court to proceed, and

[1] Dubuque & Sioux City R. Co. *v.* Pierson (1895), 70 Fed. Rep. 303.

[2] Mercantile Trust Co. *v.* Portland & Ogdensburgh R. Co. (1882), 10 Fed. Rep. 604.

[3] McAllister *v.* Plant (1876), 54 Miss. 106; s. c. 17 Am. Ry. Rep. 389. See Perry on Trusts, §§ 343, 344.

[4] Gibbes *v.* G. & C. R. Co. (1879), 13 S. C. N. S. 228; 4 Am. & Eng. R. R. Cas. 459; Mobile & Cedar Point R. Co. *v.* Talman (1849), 15 Ala. 472; McAllister *v.* Plant (1876), 54 Miss. 106; s. c. 17 Am. Ry. Rep. 389; Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush (Ky.), 673; s. c. 18 Am. Ry. Rep. 221.

[5] 33 Gratt. 473; s. c. 1 Am. & Eng. R. R. Cas. 473 (1880).

take upon itself the execution of the trust, on the principle that a court of equity will never suffer a trust to fail for want of a trustee. If, however, the legal title was not in abeyance, then upon the death of Lamar it either devolved by operation of the statute on Lamar's personal representative, or else it resulted to the old companies; and in either case such title was represented by parties before the court. The court, having possession of the property, works, rights, and franchises of the company, will have no difficulty in conveying the mere legal title to the purchaser whenever it becomes necessary and proper." Of the three alternative doctrines here suggested, that which supposes the trust property to devolve upon the personal representatives of the surviving trustee is the one which accords with the general law of trusts.[1]

If a public functionary is made trustee *ex officio*, as where the mortgage is made to the Treasurer of the State "and his successors in office," the trust will devolve upon his successors in office, and will not be retained by him after the termination of his official duties.[2]

§ 274. **Powers of Trustees generally.** — The trustee can only do with the trust property what the deed, either in express terms or by necessary implication, authorizes him to do.[3]

He is not a general, but a special, agent of the bondholders, and he is limited to the legitimate purposes of the relation he sustains to the security and the parties entitled to the benefit thereof, under the trust with which he is clothed.[4]

The implied limitation upon his powers is that they do not extend beyond matters affecting the enforcement of the security, and the administration of the trust property, in so far as it may be under his control.[5]

He cannot bind the bondholder personally by a contract entered into for supplies to be furnished for the use of a road which he is operating in fulfilment of his trust duties and not otherwise.[6]

1 Perry on Trusts, §§ 343, 344.

2 Board of Supervisors *v.* Mineral Point R. Co. (1869), 24 Wis. 93.

3 Fidelity Insurance, Trust, & Safe Deposit Co. *v.* Shenandoah Valley R. Co. (1889), 32 W. Va. 244; s. c. 9 S. E. Rep. 180; 38 Am. & Eng. R. R. Cas. 577.

4 Miller *v.* Rutland & Washington R. Co. (1863), 36 Vt. 452; Appeal of Harrisburg & Eastern R. Co. (Pa. Sup. Ct., 1888), 36 Am. & Eng. R. R. Cas. 249.

5 See the two cases last cited.

6 Chaffee *v.* Rutland Railroad Co. and Trustee (1881), 53 Vt. 345; s. c. 4 Am. & Eng. R. R. Cas. 212.

In this case the trustees had continued to operate the road by the procurement and in the interest of the defendant company organized after foreclosure by the bondholders. The contract on which recovery was sought was at first verbally entered into just after the organization, and subsequently reduced to writing. One of the trustees was at this time acting in the double capacity of president of the company and as one of the trustees of the

Nor does his authority necessarily include the power to place the bonds upon the market for sale, and the exercise of such a power is enough to put a purchaser of the bonds on inquiry as to the regularity of their issue.[1]

§ 275. **Bondholders' Rights under the Mortgage cannot be altered by the Trustees without their Consent.** — A non-assenting bondholder, therefore, is not bound by a scheme of reorganization by which his mortgage is to be postponed to three others which are to replace it. Such a scheme "can only be made effective in one of two ways, — by the consent of all the bondholders, or by a foreclosure cutting off their lien, and so enabling a new corporation to make its own mortgages in its own way. A bondholder has a clear right to stand upon his contract, and the trustees have no power or authority to compel him to make a new and different one."[2] So also it is outside the powers and duties of a trustee of a mortgage drawn in the usual form to undertake to give his assent, in behalf of the bondholders, to a scheme involving the allowance of a preference to the floating unsecured debts of the company.[3] Nor has he the power to discharge, change, or compromise the security, which he holds as trustee.[4]

So also, as his implied powers do not extend to the release of the mortgage, he must, if such a power is conferred on him by the trust instrument, execute it in the manner prescribed therein, or, at all events, not until the condition of defeasance has been performed; and a subsequent purchaser must, at his peril, ascertain whether there has been such a performance.[5]

bondholders. The other had never acted, nor pretended to act, except in the single capacity of trustee. The defendant company had never authorized the making of the contract, and there was no finding that the trustees held any such relation to the company as authorized them to bind it by their contract. Under these circumstances it was held, first, that the bondholders, as such, were not bound, since the relationship between the trustees and *cestuis que trust* is not one of agency; and, secondly, that the company was equally exempt from liability because there had been no act, or omission to act, on its part, from which the plaintiff had a right to understand that the trustees had the right to bind, or were in fact binding, it to the performance of the contract. It was also contended that there had been a novation by which the company had assumed the burden of the contract. But it was held that the facts in evidence were insufficient to establish any such change in the relations of the parties.

[1] Riggs *v.* Pennsylvania & New England R. Co. (1883), 16 Fed. Rep. 804. See also Chap. II. (*bona fide* purchaser).

[2] Hollister *v.* Stewart (1889), 111 N. Y. 644; s. c. 19 N. E. Rep. 782; 38 Am. & Eng. R. R. Cas. 599; Nelson *v.* Hubbard (1892), 96 Ala. 238; s. c. 11 So. Rep. 428; 12 Ry. & Corp. L. J. 182.

[3] Duncan *et al.* *v.* Mobile & Ohio R. Co. (1876), 2 Woods, 542; s. c. 8 Fed. Cas. 17, Case No. 4187.

[4] Miller *v.* Rutland & Washington R. Co. (1863), 36 Vt. 452, 483.

[5] Fidelity Insurance, Trust, & Safe Deposit Co. *v.* Shenandoah Valley R. Co. (1889), 32 W. Va. 244; s. c. 9 S. E. Rep. 180; 38 Am. & Eng. R. R. Cas. 577.

So also, if the sole authority of a trustee in case of a foreclosure sale is to purchase the property, upon receiving the written request of a majority of the bondholders, and thereupon to take certain prescribed steps looking to the reorganization of the bondholders into a new corporation, to which he is to convey the property thus purchased, he has no right to sell the property even though requested to do so by a majority of the bondholders. The dissent of a single bondholder is enough to invalidate such a sale. It makes no difference that the reorganization scheme which the mortgage calls for has apparently become impossible of execution, for the reason that the majority of the bondholders have pronounced in favor of the sale. If the trustee refuses to sell, as being beyond his authority, it is a reasonable presumption that those who are seeking the sale will concur in the reorganization rather than the contrary. And even if for this reason, or for any other, the due execution of the trust seems to the trustee impossible, he should ask for the direction of a court. To allow him such a measure of discretion as a sale under such circumstances would imply, might, in many cases, make him independent and despotic.[1]

Such an excess of his powers by the trustee, however, cannot be taken advantage of by a bondholder who, either by previous consent or subsequent ratification, has sanctioned the act.[2]

§ 276. **The Power to declare the Principal due.** — This power is not rendered imperative by the addition of a clause to the effect that, "upon the written request of the holders of a majority of the bonds, the trustee shall proceed to collect both principal and interest." Such an agreement with regard to the result of the non-payment of interest is in the nature of a penalty, and must be strictly construed. The true meaning of the added clause, therefore, is that the majority of the bondholders shall have the right to veto the proceedings of the trustee, and the written request mentioned is a condition precedent to any action by the trustee to enforce the bonds. Only by such a construction is it possible to effect what is evidently one purpose at least of such a clause; viz., to protect the bondholders as a class against the views of individuals and combinations of individuals, being a minority, pursuing separate interests.[3] While the majority can-

[1] James *v.* Cowing (1880), 82 N. Y. 449; 38 Am. & Eng. R. R. Cas. 336.

[2] Butterfield *v.* Cowing (1889), 112 N.Y. 486; s. c. 20 N. E. Rep. 369, a case dealing with the same matter as the one last cited.

[3] That the various limitations imposed by trust deeds upon the exercise of this power do not affect the power of the trustee to foreclose upon being requested to do so by one or more of the beneficiaries, see Chap. XVIII. (foreclosure).

not and ought not to prevent others, even a single individual, from exacting the promptest payment of what is due and may be important as current income, by legal process, they may nevertheless rightfully object to an anticipation of payment that may in their opinion prove a sacrifice.[1]

A provision in a mortgage that no action shall be commenced by reason of any default on the part of the mortgagor by the trustee, except upon the reasonable request of the bondholders, is not a limitation upon the right and power of the trustee to institute proceedings whenever in its judgment such a course is needed in the interests of the bondholders. Primarily it is left to the discretion of the trustee to determine whether proceedings for foreclosure should or should not be instituted.[2]

A letter from a bondholder informing the trustee of a mortgage that the writer is the holder of a majority of the bonds of a corporation, and that he desired "to ask the proper court to foreclose and sell the property," and asking the trustee "what action" he would take, and adding that he had attorneys prepared to act, who would arrange for the trustee's protection "in any manner that may be necessary," will not be interpreted to amount to a request on the part of the holder of the majority of bonds of the trustee to take action; and the failure on the part of the trustee to act in such case will not justify an action on the part of the bondholder to foreclose the mortgage.[3]

The trustee of a mortgage, upon the receipt of such a letter, has a right to ask that the bonds of the bondholder be deposited with him for inspection, as well as to require of the bondholder that he indemnify him against loss before bringing a suit for foreclosure of the mortgage.[4]

Where a mortgage provides that, at the request of the holders of two million dollars of the mortgagor's bonds, the trustee must institute foreclosure proceedings, and a request is made by a bank claiming the ownership of one million seven hundred thousand dollars of the bonds, and to represent a sufficiency in amount of other bonds, if it appear that in reality the first-named bonds were the property of the competing railroad company, and that this company had simply contracted to purchase the latter-named bonds, this request would be insufficient to justify a foreclosure

[1] Chicago, D. & V. R. Co. *v.* Fosdick (1882), 106 U. S. 47; s. c. 7 Am. & Eng. R. R. Cas. 427, Waite, C. J., dissenting.

[2] New York Security & Trust Co. *v.* Lincoln St. Ry. Co. *et al.* (1896), 74 Fed. Rep. 767.

[3] Beebe *v.* Richmond Light, Heat, & Power Co. (1895), 13 Misc. Rep. 737; s. c. 35 N. Y. Suppl. 1.

[4] Ibid.

suit; and one having been brought under such a request by the trustee, the trustee's right of action, in spite of the invalidity of the request, will not be upheld because the trustee might in its discretion have brought the suit without a request.[1]

§ 277. **The Power of a Trustee to waive Defaults in Interest or Principal.**— The existence of this power, subject only to the control of a majority in interest of the bondholders will not be readily inferred; for the effect of admitting it would be to enable stockholders of the company, by buying a trifling excess over half of the bonds, to practically annul the whole debt, and take to themselves the entire net earnings of the business.[2]

§ 278. **Trustee's Power of Entry.** — This power is regarded as a vested right of the bondholders, which cannot be impaired by subsequent legislation, either direct or indirect.[3] It exists as long as there is default in the payment of any of the coupons. The acceptance of the preferred stock of a new corporation in lieu of bonds affects the rights only of those bondholders who assent to this arrangement, and is not a waiver of the right of the trustees to take possession of the property for the benefit of those who do not assent.[4]

The trustees, in a Minnesota case, having acquired possession of the road, were held expressly authorized to collect and receive

[1] Farmers' Loan & Trust Co. *v.* New York & Northern Ry. Co. (N. Y. Ct. of App., 1896), 44 N. E. Rep. 1043.

[2] Hollister *v.* Stewart (1889), 111 N. Y. 644; s. c. 19 N. E. Rep. 782; 38 Am. & Eng. R. R. Cas. 599. There the trustees were required to exercise their power of entry or sale, or both, if the default was in the payment of interest or principal of the bonds, upon the requisition of the holders of one-fourth of the aggregate amount of the bonds; while if the default was in anything required to be done for the further assuring of the title of the trustees to any property of the company, or in any provisions contained in the mortgage to be performed by said company, the requisition was to be as aforesaid; but it was left within the discretion of the trustees to enforce or waive the rights of the bondholders by reason of such default, subject to the power hereby declared of a majority in interest of the holders of the said bonds, by requisition in writing, or by a vote at a meeting duly held, to instruct said trustees to waive such default, or to enforce their rights by reason thereof. It was held that, in spite of the generality of the words "in any provisions herein contained to be performed or kept by said company," this article of the mortgage must be construed to relate to the provisions respecting covenants for assurance, etc., and not to those in regard to which other and more stringent directions had been given in other parts of the instrument.

In Randolph *v.* Larned (1876), 27 N. J. Eq. 557, the trustees of a first mortgage were held entitled to the property of a railroad company in preference to a receiver under the Insolvent Corporation Acts of New Jersey, and permitted to operate the road.

[3] See also Chap. XVIII. (suits for possession); Cheever *v.* Rutland & Burlington R. Co. (1869), 4 Am. Ry. Rep. 291.

[4] Cheever *v.* Rutland & Burlington R. Co. (1869), 4 Am. Ry. Rep. 291.

all tolls, freights, incomes, rents, and issues of the same, and of every part thereof.[1]

The rights acquired by the stipulation in the trust instrument granting the power may be enforced by a bill for specific performance,[2] or the trustee may resort to an action of ejectment.[3]

§ 279. **The Power of Sale.**[4] — This power being a legitimate part of a trust instrument, the trustee's sale will, if carried out according to the terms of the instrument, divest the title of the company, without a foreclosure.[5]

Being a power annexed to the estate, and coupled with an interest, it is necessarily irrevocable. It becomes part of the mortgage security, and vests in any person who, by assignment or otherwise, becomes entitled to the money secured to be paid.[6]

A mortgage which makes it the duty of trustees to take possession after default, on the application of a certain percentage of the bondholders, and also declares that they are authorized to sell at their option "upon the like application," entitles them to decline to sell, after entry, or both to enter and sell, as they may think proper.[7]

The trustee with such a power has the right to decide in the first instance upon the sufficiency of the claim of the bondholders who seek to have the property sold to pay the bonds which they profess to hold; but the railroad company has also the right to appeal to the courts to have the validity of that claim passed upon.[8]

The execution of the power of sale by the trustee may be controlled by a court of equity at the suit of a *cestui que trust*.[9]

The power of sale is rarely exercised. It appears in many railroad mortgages where it is entirely inoperative because the statutes of the State where the property is situated forbid such a power from being exercised.

Where trustees of a mortgage securing bonds of a corporation are proceeding to sell the property under a power of sale in their

[1] Rice *v.* St. Paul & Pacific R. Co. (1878), 24 Minn. 464.

[2] Shepley *v.* Atlantic & St. Lawrence River R. Co. (1868), 55 Me. 395.

[3] Rice *v.* St. Paul & Pacific R. Co. (1878), 24 Minn. 464.

[4] See also Chap. XVIII. (suits for possession); Bradley *v.* Chester Valley R. Co. (1860), 36 Pa. St. 141; Perry on Trusts, § 602.

[5] Brunswick & Albany R. Co. *v.* Hughes (1874), 52 Ga. 557; s. c. 7 Am. Ry. Rep. 137.

[6] Bradley *v.* Chester Valley R. Co. (1860), 36 Pa. St. 141.

[7] Macon & Augusta R. Co. *v.* Georgia Railroad & Bkg. Co. (1879), 63 Ga. 103; s. c. 1 Am. & Eng. R. R. Cas. 378.

[8] Western Division of Western North Carolina R. Co. *v.* Drew *et al.* (1877), 3 Woods, 674.

[9] Youngman *v.* Elmira & Williamsport R. Co. (1870), 65 Pa. St. 278.

mortgage for the benefit of a holder of its bonds who shows a good title to his bonds, a court of equity will not enjoin the sale till the corporation can have adjudicated an unliquidated and disputed claim against the holder of the bonds.[1]

§ 280. **Trustee not confined to the Exercise of a Single Power only.** — A trustee who is given both the power of entry and sale need not confine himself to either measure, but may first enter and then sell, using the road for the purposes of the trust until the sale is effected.[2]

§ 281. **Special Powers of Trustee for Enforcement of the Security cumulative upon the Right of Foreclosure.**[3]

Article III. — Effect of Notice to Trustee.

§ 282. **Bondholders affected with Notice of Everything of which their Trustee is notified in the Course of Litigation concerning the Bonds.** — It will be shown in another chapter that for all purposes of active litigation to which a trustee is a party he represents the bondholders, and binds them fully by what he does in the course of the proceedings, unless he is shown to have been guilty of a breach of his fiduciary duties. Notice of any step taken by the court at the instance of other parties will operate as notice to the bondholders. Thus notice to a trustee of an application by a receiver for permission to issue certificates is notice to the bondholders; and if the trustee makes no objection to the issue, the bondholders are bound by the action of the court in granting the application.[4]

Especially is a bondholder concluded by the action of the trustee where the latter is a State official designated by statute, and not a person selected by the contract of the parties. Foreclosure proceedings and a subsequent reorganization carried through by such an official will, therefore, bind each bondholder though he has no notice thereof.[5]

[1] National Rubber Co. *et al.* *v.* Rhode Island Hospital Trust Co. *et al.* (R. I., 1895), 33 Atl. Rep. 254.

[2] Macon & Augusta R. Co. *v.* Georgia Railroad & Bkg. Co. (1879), 63 Ga. 103; s. c. 1 Am. & Eng. R. R. Cas. 378; McAllister *v.* Plant (1876), 54 Miss. 106; s. c. 17 Am. Ry. Rep. 389.

[3] See Chap. XVIII., on cumulative character of remedies.

[4] Wallace *v.* Loomis (1877), 97 U. S. 146, 163; Union Trust Co. *v.* Illinois Midland R. Co. (1886), 117 U. S. 434, 463; s. c. 6 Sup. Ct. Rep. 809; Kent *v.* Lake Superior Ship Canal Ry. & Iron Co. (1892), 144 U. S. 75; s. c. 12 Sup. Ct. Rep. 650; Central Trust Co. *v.* Seasongood (1889), 130 U. S. 482; s. c. 9 Supr. Ct. Rep. 575.

[5] Gates *v.* Boston & New York Air Line R. Co. (1885), 53 Conn. 333; s. c. 5 Atl. Rep. 695; 24 Am. & Eng. R. R. Cas. 143.

§ 283. **Effect of Notice to Trustee as to Matters not arising in Active Litigation.** — (a) *When Notice to Trustee has been held not to be Notice to Bondholders.* — If the trustees who take a conveyance for the purpose of upholding the estate, without having any previous connection with the title, are to be considered as invested with a merely dry, naked trust, it will probably be conceded that notice to them is not always, nor perhaps usually, regarded as notice to the *cestuis que trust.* The leading case in which this theory has been made the partial basis of a decision that notice to a trustee in a corporate mortgage is not effectual as notice to the bondholders is Curtis *v.* Leavitt,[1] in which Judge Paige, after pointing out that the grounds here assigned for upholding the claims of the bondholders, as *bona fide* purchasers of the securities, without notice of irregularities in their issue, was not necessary for the decision of the case, and that it rested upon the individual opinion of two judges, the other four having arrived at the conclusion that these irregularities did not vitiate the issue, on the broader grounds that it was within the scope of the corporate powers, and that the alleged defects had been cured by subsequent acts of recognition and ratification, expressed his reasons in the following language: "The trustees are not to be regarded as the purchasers of the bonds and mortgages assigned to them. No consideration proceeded from them; they were mere assignees of these securities, coupled with no interest in trust to hold them as a security for the payment of all the mortgage bonds that should thereafter be sold or negotiated by the company, and, after the payment of such bonds, to hold the same subject to the disposition of the company. Whoever purchased the mortgage bonds became purchasers of the bonds and mortgages so assigned as security for their payment, or of an equitable right to hold them as such security." Nor, it was thought, could the contention be supported on the ground that the trustee stood in the relation of an agent as respects bondholders. "He was selected," said the learned judge, "by the company, not by the *cestuis que trust.* His powers and duties were conferred and prescribed by the company, not by the bondholders. There were at the time of the execution of the trust deeds no bondholders, — no *cestuis que trust.* It is a necessary attribute of an agency that it should be created by the principal. . . . The doctrine that notice to an agent operates as constructive notice to his principal is applicable only to cases where an agency in fact has been created, and in such cases only where the notice is to the agent while engaged in the same transaction or negotia-

[1] 15 N. Y. 9 (1857).

tion to which the agency applies." In this case, as the relation of principal and agent did not exist between the bondholders and Graham, notice to him or knowledge by him that there was no previous resolution was not constructive notice to the bondholders.[1]

The arguments here used were accepted as convincing in a similar case by the Supreme Court of the United States, where the court held that, where a railroad company mortgaged, for the purpose of securing its own bonds, various property, including certain aid bonds issued by a county, the knowledge of one of the trustees that the aid bonds were irregularly issued did not, in a suit brought to enforce them, operate to deprive the holders of the company's bonds of their rights as *bona fide* purchasers without notice.[2]

So also in Hay *v.* Alexandria & Washington R. Co.,[3] the court held that, although the trustee had personal notice of an execution on the company's property, this notice could not bind the bondholders represented by him, who took the bonds without notice, and that, for all purposes of notice, the trust deed was in the case in question to be treated as made to the bondholders. No reasons for this ruling are given.

(b) *When Notice to Trustee has been held to be Notice to Bondholder.* — Other courts have adopted the doctrine that bondholders, in *all* matters affecting their security, are charged with the knowledge of the trustees. The most elaborate statement of this view is contained in the opinion delivered by Judge Barrett in Miller *v.* Rutland & Washington R. Co.,[4] where some weighty reasons are given for rejecting the theory propounded in Curtis *v.* Leavitt, *supra*, which is affirmed to be not only founded on an erroneous conception of the functions of a trustee of this description, but also productive of much injustice in its practical operation. "Whatever title the *cestuis que trust* have, whether legal or equitable, is through and by virtue of the title conveyed to and held by the trustees. Even if it should be granted that the trustees were agents merely for holding the legal title, still, as the rights of the *cestuis que trust* depend upon, and are to be asserted through, the legal title, whatever affects such title in its creation in the trustees must affect the rights and interests that are dependent on it. If the legal title is charged with an incumbrance in its

[1] See criticism of Judge Barrett in Miller *v.* Rutland & Washington R. Co. (1863), 36 Vt. 452. See also National Waterworks Co. of N. Y. *v.* Kansas City (1896), 78 Fed. Rep. 428.

[2] Johnson County *v.* Thayer (1876), 94 U. S. 631.

[3] 20 Fed. Rep. 15 (1884).

[4] 36 Vt. 452 (1863).

creation in the hands of the trustees, it is difficult to see how the *cestuis que trust* can have an equity suspended upon the legal title that shall override such incumbrances. However that might be as a proposition applicable to a dry trust, still, as to a trust which, in addition to the holding of a title, is administrative of the property for the purpose of rendering the security effective, the trustees must be regarded as the agents of the *cestuis que trust* with reference to all their rights and interests, both in the title held and in the administration and fruits of the trust, according to its terms and legal operation. The fact that the bonds are treated as negotiable, and pass from hand to hand like bank-bills, does not affect the question of the agency of the trustees in reference to the security provided by the mortgage. Such bonds purport to be secured by a mortgage in trust to trustees who are designated and known. They are negotiated and purchased upon the security thus existing. By the purchase of the bonds, the purchaser voluntarily adopts the security as it exists in the trustees, and becomes a *cestui que trust* under them, thereby adopting said trustees as his agents for holding the existing title and administering the property held thereby to the intents specified in the creation of the trust. The question is not how *cestuis que trust* would be affected by notice to trustees of transactions subsequent to the creation of the trust, or to their becoming *cestuis que trust*, but as to how they are affected by notice to the trustees, which, as to them personally, affects the legal estate at the time and in the act of their becoming trustees."

The learned judge then discussed the practicability of a contrary doctrine, pointing out that the fact of the bonds passing from hand to hand, almost daily, without record or notice, shows that the matter of fixing an equity by actual notice to the holders would be virtually impossible. The result would necessarily be that, however well grounded an equity a party might have against the corporation, and against the trustees personally, attaching upon the legal title held by such trustees, it would prove barren and futile to any beneficial intent, by reason of the impossibility of knowing and notifying the ever-shifting parties who have an interest, and claim an equity, subsequently created and subsequently accruing. On the other hand, it would be comparatively easy for persons desirous of investing in railroad bonds to apply to the trustees holding the security, and elicit the true state of the title; and it was declared to be, in the opinion of the court, no hardship that they should be required to do so. The conclusion arrived at was that the bondholders secured by a second mort-

gage should be postponed to those secured by an earlier instrument which took effect as an equitable mortgage, and of which the trustees of the second mortgage had actual notice.

For similar reasons, more briefly expressed, the mortgage bondholders secured by an after-acquired property clause had previously been held in New Hampshire to take their securities subject to the lien of an agreement known to one of the trustees, whereby a portion of that property was to be liable to be removed by certain parties, if the money which they had advanced for the purpose of enabling the company to take it from the custom-house, where it was held for duties, was not repaid at a certain time. The court said that under the mortgage in question the trustees "must be considered in the light of agents for the negotiating of the loan; they act for those who lend their money on the security of the mortgage; they are charged with the duty of protecting the interests of the bondholders, who are unconnected individuals, having no ready means of acting together except through the trustees, whom the law appoints to act for them. Notice to the trustees would be all that could be given in this case."[1]

In West Virginia this has been carried to its strict logical conclusion, and applied to a case in which a bondholder was merely shown to be aware of facts which put him upon inquiry as to the existence of a prior equitable lien.[2]

From the above summary it is apparent that the important question is left by the authorities in an extremely unsatisfactory position. There are doubtless serious difficulties involved in the adoption of either of the opposing doctrines. If, on the one hand, the rule is established that intending purchasers of bonds must, at their peril, inquire of the trustee and ascertain whether he is aware of the existence of any prior equity, the value and negotiability of these instruments will be much impaired. On the other

[1] Pierce *v.* Emery (1856), 32 N. H. 484. Compare Skiddy *v.* Atlantic, O. & M. R. Co. (1879), 3 Hughes, 320; Redf. Am. Ry. Cas. 568 (1879); Claflin *v.* South Carolina R. Co. (1880), 8 Fed. Rep. 118, 133. In the last-mentioned case a railroad company gave its notes to a financial institution controlling a claim against an embarrassed company, an important feeder to itself, in the stock of which it owned a controlling interest, the object being to prevent its falling under the control of an antagonistic interest, and secured these notes by its second-mortgage bonds as collateral. For several years there was no complaint, and one of the trustees named in the mortgage was a director during these years with a knowledge of all that was done. *Held*, that it was too late for other bondholders, after many of these bonds had been sold under the pledge, to object to their use or dispute their lien.

[2] Fidelity Insurance, Trust, & Safe Deposit Co. *v.* Shenandoah Valley R. Co. (1889), 32 W. Va. 244; s. c. 9 S. E. Rep. 180; 38 Am. & Eng. R. R. Cas. 577.

hand, it seems scarcely consistent with justice that the secured creditors, by thus interposing a trustee between themselves and the company, should be able to obtain a higher rank for their claims than parties who have acted with due diligence in giving the only kind of notice of which the circumstances admit. That the bondholders in such a case should be permitted to postpone existing equities in favor of theirs is a far more stringent doctrine than that which entitles *bona fide* transferees of a note secured by a mortgage to enforce the mortgage without regard to equities between the original parties.[1] The technical objection that the trustee cannot be the agent of those who purchase the bonds, for the reason that he is appointed, not by them, but by the corporation, seems to be sufficiently answered by the theory propounded in Miller *v.* Rutland & Washington R. Co., *supra,* that the act of purchase may be deemed to amount to an acceptance of the trustee as agent, subsequent ratification being here regarded, according to the ordinary rule, as equivalent to a prior appointment. The question, therefore, is pre-eminently one to be settled by a resort to general considerations of commercial expediency.

ARTICLE IV. — DUTIES OF THE TRUSTEE GENERALLY.

§ 284. **The General Duties of the Trustee are the same as those of other Trustees.** — He must act in good faith for the best interests of the bondholders; he must take care that the property is not wasted nor depreciated; he must see that the income is not improperly diverted from the payment of interest on the mortgage as it accrues; and, in case of a manifest purpose on the part of the mortgagor to waste or destroy the property, or not to apply the income to payment of interest, to the injury of bondholders, it is the trustee's duty to take possession of the property and manage it for the security of the *cestuis que trust.*[2]

A trustee for bondholders, authorized by them to purchase the property at a foreclosure sale with a view to reorganization with obligations on the side of the bondholders, to exchange their bonds for those of the reorganized corporation, to pay assessments, etc., has a right to abandon the sale and to refuse to complete it upon the failure of a sufficient number of bondholders to meet their obligations under the agreement. This would leave the property under the lien, and a resale could be had under the decree. But,

[1] See Dan. on Neg. Instr., § 834.

[2] Sturges *v.* Knapp (1858), 36 Vt. 1; First National Fire Ins. Co. *v.* Salisbury *et al.* (1881), 130 Mass. 303; s. c. 4 Am. & Eng. R. R. Cas. 480.

after bidding off the property as the trustee of the bondholders, and proceeding to complete the purchase made as their trustee, he will be held bound by all the terms of the trust until released therefrom by the bondholders. And if he, in such a case, sells the property to third parties, the bondholders will be entitled to relief against the trustee, and may follow the property in trust in the hands of the purchaser.[1]

§ 285. **The Duties of a Trustee become active when a Default occurs, and are not then merely ministerial.** — From the usual terms of mortgages it follows that, unless the safety of the security is threatened by the mortgagor or by attacks from without, or there has been a default in the payment of the bonds or the interest, the trustee has no active duties to perform, but is simply the depositary of the title to the property mortgaged. "The actual possession of the franchises and the property remains in the railroad company to enable it to discharge its duties to the public, and earn an income from which to pay its liabilities. But when a default occurs, the duties of the trustee become active and important; he represents all the bondholders, and is under obligation to protect them, so far as the property in his hands in trust for them will enable him to do so."[2]

The duties of a trustee, after forfeiture, become, not only active and responsible, but critical and delicate. He must then elect between delay and action; between, on the one hand, taking possession of the road and its fixtures where he is entitled to do so, and, on the other, delay and consequent further embarrassment, complication, and loss, or he must undertake the ulterior and final remedy of foreclosure. It is the sole or the first purpose of his office that he should act, and should exercise his wisdom and discretion upon the possible occurrence of the emergency of a default. He is selected with reference to his capacity and responsibility for this very contingency, both by the corporation and the *cestuis que trust;* and neither of these parties has stipulated to deal directly with the other, but only with the trustee, as the responsible party.[3]

[1] Indiana, Ill. & Iowa R. Co. *v.* Swannell, Exr., *et al.*, 157 Ill. 616; s. c. 41 N. E. Rep. 989 (1895), affirming Same *v.* Same, 54 Ill. App. 260.

[2] Commonwealth *v.* Susquehanna & Delaware River R. Co. (1888), 122 Pa. St. 306; s. c. 36 Am. & Eng. R. R. Cas. 269. The court, after examining, in a passage of which this extract forms a part, the difference between the rights of a bondholder and an ordinary mortgagee, decided that a sale of the property and franchises of the corporation under execution of a judgment obtained by a bondholder, not as one of a class, but as an individual, did not cut off the lien of the mortgage, as would have been the case had the property been sold to satisfy an ordinary mortgage.

[3] Sturges *v.* Knapp (1858), 31 Vt. 1.

In carrying through a foreclosure suit, it is not enough for a trustee to be ready to contest a demand against the estate to which the bondholders may call his attention. He is under the positive duty of seeing that the property is not burdened with unjust claims or unnecessary expenditures.[1]

A court of equity will take jurisdiction of the trusts created by the mortgage, and compel the trustees to execute them in the manner indicated by the terms of the instrument itself.[2]

Thus, if the trustee neglects or refuses to move after a default, any bondholder may proceed, by bill filed on behalf of himself and the other members of the class of creditors to which he belongs, to compel a sale of the mortgaged premises, a removal of the trustee, or such other relief as may be appropriate.[3]

The duty imposed upon a trustee by the ordinary provision, that, if the payment of principal and interest continues in default for a specified period, he shall, upon receiving the request of a certain proportion of the holders of the bonds, take possession and sell it in the manner prescribed, is purely ministerial, and, if the necessary requisition is made, he has no option but to comply with it.[4]

And as the remedy of foreclosure may be put in motion independently of any such requisition,[5] the trustee may be compelled, upon a proper showing, to comply with the demand of any number of the bondholders, to enforce the security in that manner. Thus, where it is provided that, until default and for six months thereafter, the mortgagor shall remain in possession, and that, on request of one-half of the owners of the bonds, the trustees might, upon the continuance of a default for six months, sell the road, bondholders owning only one-sixth of the amount of the issue secured by the mortgage may maintain a bill in equity to compel the trustees to take possession of the property, for the purpose of foreclosing the lien, where it is alleged that there has been a default in the payment of the interest on the bonds; that the corporation has signified a purpose not to pay interest on the bonds unless the holders thereof will take a less rate than that which

[1] De Betz's Petition (1878), 9 Abb. N. C. 246.

[2] Bradley *v.* Chester Valley R. Co. (1860), 36 Pa. St. 141.

[3] Commonwealth *v.* Susquehanna & Delaware River R. Co. (1888), 122 Pa. St. 306; s. c. 15 Atl. Rep. 448; 36 Am. & Eng. R. R. Cas. 269.

[4] Shaw *v.* Norfolk County R. Co. (1855), 5 Gray (Mass.), 162; Bradley *v.* Chester Valley R. Co. (1860), 36 Pa. St. 141; Wilmer *v.* Atlanta & Richmond Air Line Ry. Co. (1875), 2 Woods, 409; Maryland *v.* Brown (1885), 64 Md. 199; s. c. 1 Atl. Rep. 54; 6 Atl. Rep. 172; 24 Am. & Eng. R. R. Cas. 192.

[5] See chapters on remedies.

the bonds call for; that the net income of the corporation is insufficient to pay the interest on the bonds; that the corporation is applying the income to unsecured debts; and that there is danger that, if this course is continued, the property will be inadequate security for the payment of the mortgage. To such a bill it is no defence that litigation may be necessary to ascertain what property is covered by the mortgage, or that a great burden and personal liability for injuries done and debts subsequently incurred will thereby be imposed on them. This burden and this liability are incident to the trust which the trustees assume in taking the mortgage, and it is not for them to say that the *cestuis que trust* must suffer because it is inconvenient or burdensome for them to do their duties as trustees.[1]

Where the primary right to proceed is in the trustees and not in the bondholders, as is the case under the Florida Improvement Act, it is the absolute duty of the trustees to proceed against the property which stands as the security of the bondholders, when the interest is in default, and no funds are available from the other sources provided in the act.[2]

The relation between mortgage trustees and bondholders is not such as makes it the trustee's duty in every case to promptly foreclose the mortgage without any request from the bondholders. It follows that the failure of a trustee to foreclose for a long time after default will not give a bondholder the right to bring an action for foreclosure on the ground of abandonment or neglect on the part of the trustee.[3]

§ 286. **The Duties of the Trustees are owed to the Bondholders severally as well as collectively.** — They are, therefore, not at liberty to follow the advice or comply with the wishes of a majority of the bondholders. The minority may still hold them liable for a faithful administration of the trust. Nor are they allowed to discriminate between members of the same creditor class. The bonded debt is a unit, so far as their duties and powers are concerned, and they must regard the bondholders as a class, not as individuals.[4]

A voting power which the trustee of a mortgage of stock is entitled under the instrument to exercise, after a three months'

[1] First National Fire Ins. Co. *v.* Salisbury (1881), 130 Mass. 303; s. c. 4 Am. & Eng. R. R. Cas. 481.

[2] Florida *v.* Anderson (1875), 91 U. S. 667.

[3] Beebe *v.* Richmond L. H. & Power Co. (1893), 13 Misc. Rep. 737; s. c. 35 N. Y. Suppl. 1.

[4] Sturges *v.* Knapp (1858), 36 Vt. 1; Commonwealth *v.* Susquehanna & Delaware River R. Co. (1888), 122 Pa. St. 306; s. c. 15 Atl. Rep. 448; 36 Am. & Eng. R. R. Cas. 269.

default in the interest, should be used for the advantage of all the *cestuis que trust*, and not in obedience to the desires of the majority.[1]

A trustee of more than one mortgage must take such action as will preserve the interests of the bondholders secured by all the mortgages, and not simply those secured by the first one.[2]

§ 287. **A Trustee's Duties are personal, and cannot be delegated.** — He is, therefore, liable for damages caused by allowing other persons to institute proceedings and to sell the trust property.[3]

For the same reason he incapacitates himself for the performance of the trust by voluntarily removing to and becoming a permanent resident of a foreign country. By such a change of domicil he will be deemed to have vacated his office, and if he attempts to prosecute an action, as trustee, in the United States court, a State court may enjoin him from proceeding in the case.[4]

§ 288. **A Trustee should consult the Court,** and is justified in doing so, when the words of the trust deed which prescribe his duties are ambiguous,[5] or where the due execution of his trust seems impossible.[6]

§ 289. **When a Trustee may be required to report to the Court.**— The rule that the trustee must, when so required, report to the court, is applicable to a case in which a court of equity, in the exercise of its general jurisdiction, has appointed the trustees called for by the provisions of a statute authorizing a mortgage, although no express reference to such reporting is made either in the statute or the order of appointment.[7]

A like duty is incumbent on a trustee who has been placed in possession of the property in course of proceedings for foreclosure.[8]

[1] Toler *v.* East Tennessee, V. & G. Ry. Co. (1894), 67 Fed. Rep. 168.

[2] Central Trust Co. *v.* Texas & St. Louis Ry. Co. (1885), 23 Fed. Rep. 846.

[3] Merrill *v.* Farmers' Loan & Trust Co. (1881), 24 Hun, 297. In this case the trustee was held responsible for the loss sustained by allowing certain contractors who held a large quantity of the bonds to control the foreclosure proceedings and to arrange among themselves for a sale, without giving any notice to outside bondholders of the time of sale, the contractors being thus enabled to obtain the property at an unreasonably low price.

[4] Farmers' Loan & Trust Co. *v.* Hughes (1877), 11 Hun, 130. Compare § 263, *ante*, as to the removal of a trustee for this cause.

[5] Denver & R. G. R. Co. *v.* United States Trust Co. (1890), 41 Fed. Rep. 720.

[6] James *v.* Cowing (1880), 82 N. Y. 449; s. c. 2 Am. & Eng. R. R. Cas. 336. See article entitled "Legal Responsibility of Trustees under Corporate Bonds and Mortgages or Deeds of Trust," by Robert Ludlow Fowler, 24 Am. L. Rev. 703.

[7] In the Matter of Eastern Railroad Co. (1876), 120 Mass. 412.

[8] Bill *v.* New Albany, etc. R. Co. (1870), 2 Biss. 390; s. c. 3 Fed. Cas. 379, Case No. 1407.

§ 290. **Trustee's Duty to account.** — No action for an accounting can be maintained against a trustee after the foreclosure sale, where he has always stood in the attitude merely of the mortgage trustee, foreclosing and selling when his trust duty required, never buying at any such sale or taking possession under it, or operating the railroad; and where, although he has received certain checks from the purchasers, and, owing to his failure to collect them, might have been made responsible for the money, the election of the bondholders to disaffirm the sale has released him from the liability incurred by this neglect of duty.[1]

§ 291. **Duty to prevent Misfeasance of Co-trustees.** — The mortgage sometimes provides that a trustee shall be liable only for his own wilful default or misconduct,[2] and this is the general rule, in the absence of any express provision in the mortgage.[3]

But a trustee will be personally liable for the acts of a co-trustee, if he becomes aware of any circumstances tending to show that the co-trustee is committing a breach of trust, and omits to take active steps to protect the trust property.[4]

§ 292. **Duty of Trustee as to Investment of Trust Funds. Sinking Funds.** — The rule is that the instructions as to investment contained in an instrument of trust are comparatively obligatory on the trustee, but that by the direction of a competent court he may depart from them. The court, however, will exercise its authority in such cases only when there is a necessity to do so, and after giving full opportunity to the parties who are to be affected by such action to be heard. The bondholders are entitled to the advantage of the agreements as made on the issuing of the bonds, and unless it appears indisputably that an occasion had arisen which calls for the action of the court, any interference with the provisions of the trust deed is unwarrantable. If a sinking fund is directed to be invested in certain specified bonds of the mortgagor company, the court will not, without the consent of the bondholders themselves, authorize the trustee to invest that fund in other bonds of the company merely because the latter would, as may be alleged, prove more remunerative in the existing condition of the money market. That the trustee recommends the change is not a sufficient reason for allowing it to be

[1] Harrison *v.* Union Trust Co. (1895), 144 N. Y. 326; s. c. 39 N. E. Rep. 353. As to duty of trustees in possession to account, see §§ 296, 301, *post.*

[2] A mortgage of this character was under review in Hollister *v.* Stewart, 111 N. Y. 644; s. c. 19 N. E. Rep. 782; 38 Am. & Eng. R. R. Cas. 599.

[3] Perry on Trusts, §§ 415 *et seq.*

[4] Weetjen *v.* Vibbard (1875), 5 Hun, 265; Perry on Trusts, § 419.

made, since, for the purposes of such an application, he does not represent the bondholders.[1]

§ 293. **The Application of the Money which comes into the Hands of the Trustees in the Execution of their Trust.** — This application should be made in such a manner as to diminish the indebtedness of the company as far as possible. In Little Rock & Fort Smith Ry. Co. *v.* Huntington[2] the trustees were required by the trust deed to apply the moneys arising from the sales of the company's lands (1) to the payment of the coupons as fast as they should become payable, to the extent that the net earnings of the business should be insufficient for that purpose; (2) to the purchase and cancellation of such outstanding bonds as could be obtained at their market value, not exceeding, however, a premium of 10 per cent; (3) to the payment of such of the bonds as should not have been purchased in accordance with these provisions, when the same should become due and payable. Any money not used for any of these purposes was to be invested in United States securities, or lent from time to time in such manner as was permitted to savings banks by the law of Massachusetts. During the first two years after the execution of the mortgage the net earnings, even when united with the proceeds of the land sales, were insufficient to meet the coupons; and an agreement was thereupon made with the holders whereby they surrendered their coupons to the trustees, and the company issued to the latter negotiable scrip, by which it promised to pay the trustees or bearer the amount of the coupons surrendered, in ten years from their maturity, with interest at the rate of 7 per cent, the company reserving the right to pay the scrip and interest at any time previous to its maturity. The scrip also provided that the trustees should hold the coupons surrendered as collateral security for the payment of the scrip thus issued therefor, and that the coupons should not be surrendered or cancelled until the scrip should be paid. Subsequently the net earnings became, and promised to continue to be, amply sufficient to meet the interest on the coupons, and the price of the bonds increased so greatly as to exceed the limit at which the trustees were entitled to purchase them. Under these circumstances it was held that as the surplus funds accruing from the land sales, if invested according to the provisions of the mortgage, would bring in a much lower rate of interest than the coupons were drawing,

[1] Fidelity Insurance, Trust, & Safe Deposit Co. *v.* United New Jersey Railroad & Canal Co. (1884), 36 N. J. Eq. 405; 12 Am. & Eng. R. R. Cas. 404. To the same effect see Clark *v.* St. Louis, Alton, & Terre Haute R. Co. (1879), 58 How. Pr. 21.

[2] 120 U. S. 160 (1887).

there was a manifest justice in the demand of the company that the money thus obtained should be devoted to taking up the outstanding coupons.

Article V. — Trustees in Possession.

§ 294. **General Statement.** — A trustee who enters into possession of the road, either *ex proprio motu* or at the instance of the bondholders, assumes a position which imposes upon him new duties and corresponding liabilities. Having taken under his charge the subject-matter of the trust, he is bound to administer it in such a manner as will promote the best interests, not merely of the bondholders whom he more immediately represents, but also of the company itself, which is justly entitled to demand that this method of liquidating the debt shall not be abused. His control of the railroad necessarily subjects him to the various responsibilities incident to the ownership of that class of property, whether as regards the public as a whole, or that portion of it with which he comes into business relations. In short, although his duty is still primarily to the bondholders, he becomes for some purposes the agent of the corporation as well, and the party to whom those who are in any way affected by the management of the road may properly look for satisfaction.

§ 295. **The Right of the Trustees to exercise the Corporate Franchises after entering for Default.** — In an early Illinois case it was contended that the trustees were incapable of operating the road of which they had taken possession, for the reason that to do so involved the exercise of the corporate franchises, which, as the law then stood in the State, could not be mortgaged or transferred. The parties had endeavored to get over this difficulty by providing that the trustees were to operate it as the agents of the company; but it was held that even without this provision the trustees were endowed with sufficient powers to enable them to maintain and operate the road: that for this purpose they might use their own proper names or adopt any other convenient business name, as any other individual or company might do; and that they were under no necessity of adopting the name of the company to whose rights in the property they had succeeded. Any other construction of the mortgage would, it was pointed out, lead to the conclusion that the rights of the mortgagee could be enforced only by taking up the road and disposing of the material; and it was thought to be impossible that the legislature, in authorizing the mortgage of the railroad prop-

erty, could have intended that any consequences so disastrous to the public should be allowed to result from the default of the company. "If," said the court, "it was the intention that the road should not be taken up and destroyed, for the payment of the mortgage debt, but that it should be sold subject to the duty towards the public of continuing and operating it as a road, it follows necessarily that it was the intention of the legislature that those into whose hands it might fall, and upon whom this duty to the public of running and operating the road might devolve, should possess all the necessary rights and powers to enable them to perform this duty. The authority to mortgage implies the authority to sell the thing mortgaged, and to convey to the purchaser all needful powers to use the thing purchased in a proper and beneficial manner." [1]

§ 296. **Trustee's Duty to account to Bondholders for the Avails of the Property.** — Trustees in possession of the road and operating it must account to the bondholders for the income while it is under their management. A failure to do so is a neglect and a violation of their duty to such bondholders, and renders them liable to a suit for an accounting. Such claims of the bondholders against the trustees, although claims on account of the bonds, are claims against the trustees personally for the moneys received to the use of the bondholders.[2]

Each bondholder has a right to receive his share of any money which comes into the hands of the trustee, and is applicable to the payment of the bonds. Whether the bondholders who have acquired their bonds since the money became available for this purpose are entitled to a share of it depends upon the nature of the transaction by which the bonds were acquired. In dealing with a demurrer to a complaint in an action brought by a bondholder to enforce his claim to such money, it will be presumed that the securities passed to the plaintiff with all their incidents, among which would be the right to have a proportionate amount of the money applied to the payment of his bonds, and that the time when the transfer occurred is, therefore, not material. The demurrer will accordingly be dismissed in the absence of some averment on this point.[3]

A bondholder's remedy to compel a trustee to account for the proceeds of the sale of property which, in accordance with the provisions of the mortgage, he has bid in at the foreclosure sale

1 Palmer *v.* Forbes (1860), 23 Ill. 301.

2 Dwight *v.* Smith (1881), 9 Fed. Rep. 50.

3 Dwight *v.* Smith (1882), 13 Fed. Rep. 795.

for the benefit of the bondholders and afterwards conveyed, is not confined to an intervention in the foreclosure suit, for the facts on which such relief is claimed do not arise until after the entry of the judgment in the foreclosure suit.[1]

§ 297. **Relation of the Trustee in Possession to the Mortgagor Corporation.** — A trustee in possession of the mortgaged property is for some purposes regarded as the agent of the corporation as well as of the bondholders.[2]

He must account for the earnings to the company,[3] or any one claiming by the same right as the company, — such as the purchaser of the equity of redemption, for instance.[4]

He is bound to manage the property with reasonable care, prudence, and faithfulness, and to apply the net income according to the legal rights of all parties.[5]

But where the trustee is known not to be a man having experience in the direct management of a railroad, he is not held responsible for the highest skill, or for failing to attain, in the operation of the road, the same degree of success which might

[1] Zebley *v.* Farmers' Loan & Trust Co. (1893), 139 N. Y. 461; s. c. 34 N. E. Rep. 1067.

[2] Ashuelot R. Co. *v.* Elliot (1874), 57 N. H. 397; s. c. 13 Am. Ry. Rep. 491; Racine & Miss. R. Co. *v.* Farmers' Loan & Trust Co. (1868), 49 Ill. 331.

[3] Racine *v.* Mississippi R. Co. *v.* Farmers' Loan & Trust Co. (1868), 49 Ill. 331.

[4] Wood *v.* Goodwin (1861), 49 Me. 260.

[5] Kennebec & Portland R. Co. *v.* Portland & Kennebec R. Co. (1871), 59 Me. 9. In this case a foreclosure sale made by virtue of proceedings instituted by a trustee in possession under a first mortgage, was attacked by the bondholders secured by a second mortgage, in which the same party was also named as trustee. Upon a review of the facts the sale was sustained; but the court, in the course of its opinion, declared a different ruling would have been proper if fraudulent or negligent conduct on the part of the trustees had been shown. "A mortgagee in possession," it was remarked (p. 47), "is undoubtedly in an important sense a trustee for the mortgagor, and bound to regard his interest. These trustees knew that in three years the equity would be foreclosed, and that it was their duty to prevent this consequence if they could legally, and had the means or money in their hands which they could, properly and consistently with their obligations to others, and with their duty under the law or stipulations under which they acted, apply to the payment of these second-mortgage coupons, due and unpaid. And we think, further, that if, having such means, they diverted them to other illegitimate objects, or entered into combinations with others to allow the time of redemption to run out, when it could have been prevented by the use of earnings or assets in their hands, which might, under their responsibilities and duties, have been so applied that the foreclosure should not be set up or held effectual. Again, if by intentional mismanagement or neglect, or by such gross and clearly proved misfeasance in their office, and inattention to the wants and interests of the road as would amount to constructive fraud, the income was thereby reduced so as to affect the net profits, which a different mode of administration would have produced, which profits would have been, or might have been, properly applied to the payment of those coupons before the three years would have expired, and would have been sufficient, we think that the same result as to strict foreclosure would follow. It would be against right, reason, and fair dealing to hold otherwise."

possibly be reached by an experienced, long-tried, and exceptional manager.[1]

§ 298. **Trustee taking Possession not an Assignee of a Lease made subsequently to the Mortgage.**[2] — The trustees of a mortgage executed prior to the leasing by the company of another road are not, when they enter into possession, bound by the terms of the lease, nor under any obligations to undertake its burdens. They will not, therefore, be required to account for the earnings of the leased road to a trustee selected by the lessor and lessee jointly, who, under the stipulations of the leases, was to receive those earnings for the purpose of being applied to the payment of the interest on the bonds, the surplus, if any, to be handed over to the lessor. Any money derived from this source is liable, as being the property of the lessor company, to be garnished in the hands of the trustees thus in possession.[3]

§ 299. **Surrender of Possession by Trustee.** — A trustee who has entered into possession by virtue of a special agreement which by its terms is plainly made for the benefit of the railroad company, to prevent the necessity of a foreclosure by either of the methods pointed out in the mortgage, must surrender the road as soon as the company is ready to pay all the interest that is due, and is in a condition to meet future instalments, although the end of the period of possession specified in the agreement may not have arrived. Under such circumstances the company may waive the condition made for its benefit if it so desires.[4]

§ 300. **Liabilities of Trustees to Third Persons.** — A trustee of a corporate mortgage, by a certificate on each of the bonds of the corporation that "This bond is one of a series of bonds within mentioned, and is secured by mortgage as therein described duly recorded," etc., does not thereby render himself liable to a purchaser of the bonds from the corporation in case the mortgage proves not to have been a first lien upon the property covered by it.[5]

[1] Kennebec & Portland R. Co. *v.* Portland & Kennebec R. Co. (1871), 59 Me. 9.

[2] Compare the similar rule as to a receiver, Chap. XXVII., *post.*

[3] Milwaukee & W. R. Co. *v.* Brooks Locomotive Works (1887), 121 U. S. 430; s. c. 7 Sup. Ct. Rep. 1094; 30 Am. & Eng. R. R. Cas. 499.

[4] Union Trust Co. *v.* Missouri, K. & T. Ry. Co. (1880), 26 Fed. Rep. 485. It was also argued that the terms of the mortgage required the possession to continue; but the court said that neither of the events had occurred which were to give the right of possession under that instrument; viz., a default in the payment of the interest, and a declaration by the majority of bondholders that the principal was "forthwith due and payable," or a request, after such default, by the holders of bonds to a certain amount to foreclose the mortgage.

[5] Byers *v.* Union Trust Co. (1896), 175 Pa. St. 318; s. c. 34 Atl. Rep. 629; 38 W. N. C. 207. See Miles *v.* Roberts (1896), 76 Fed. Rep. 919, where such a

The general rule is that the trustees who take possession of a railroad for breach of the condition in the mortgage stand in the place of the corporation, vested with all the rights and subject to all the liabilities incidental to the exercise of the franchise and the operation of the railroad.[1]

They are, therefore, liable for an injury to property caused by the creation and maintenance of a nuisance on the railroad lands, and for injuries generally caused by the negligence of those whom they employ to operate the road;[2] and their responsibility, as regards passengers and freight, is that of a common carrier.[3]

The liability in these cases is personal, for they are not in possession as receivers or officers of the court, and their accountability is to the bondholders.[4]

But where a statute expressly limits the liability of the trustees as such to the moneys received from the operation of the road, and their personal liability to malfeasance or fraud, they cannot be held absolutely liable for an injury to property by fire, under a statute which provides that, "when a building or other property is injured by fire communicated by a locomotive engine, the corporation using it is responsible for such injury." It was suggested, however, that in the proper proceedings, under an allegation of receipts beyond what was necessary to liquidate prior claims, the trustees might be required to appropriate enough to pay the claim, either as an incident to and a part of the "running expenses," or as "damages arising from misfeasance in the management of the road," which the statute defining their liabilities required them to pay.[5]

Their liability for the negligence of their employees still continues where, after entering into possession, they lease the property to others, but, under a verbal agreement, go on operating it for the lessees, and receive the earnings, pay the expenses, select, contract with, and discharge the persons employed on the road, and exercise all the powers usually exercised by railroad corporations over their own roads.[6]

certificate of the trustee was held to amount to a warranty.

[1] Daniels *v.* Hart (1875), 118 Mass. 543; Union Trust Co. *v.* Cuppy (1882), 26 Kans. 754; s. c. 11 Am. & Eng. R. R. Cas. 562.

[2] Ballou *v.* Farnum (1864), 91 Mass. 47.

[3] Barter *v.* Wheeler (1869), 49 N. H. 9; Rogers *v.* Wheeler (1870), 2 Lans. 486; on appeal (1871), 43 N. Y. 598; Sprague *v.* Smith (1857), 29 Vt. 421.

[4] Rogers *v.* Wheeler (1871), 43 N. Y. 598. Compare Sprague *v.* Smith (1857), 29 Vt. 421.

[5] Stratton *v.* European & North American Ry. Co. (1883), 74 Me. 422.

[6] Ballou *v.* Farnum (1864), 91 Mass. 47. The reasoning of the court was that, in spite of the ambiguity of the language of the agreement, that "they should continue to operate the road for the lessees," the practical construction put upon the

Nor is their liability as common carriers affected by the surrender of the whole property to a company newly organized under a decree which provides for full indemnity to them by lien upon the property, as against all liability of every description incurred or to arise out of any act or contract done or made by them as such trustees.[1]

§ 301. **Trustees in Possession are within the Purview of Statutes** imposing duties and liabilities to which the company itself is made liable, either for the reason that it is a railroad company, or for the reason that it is one of a certain class of property owners. Thus they are liable under the various statutes requiring the company to pay damages in certain cases where injuries are inflicted in the operation of the road upon person or property.[2]

So also trustees who have taken possession of a road and completed it are within the terms of a statute requiring railroad companies to erect and maintain fences and cattle-guards, and may be compelled by a decree of specific performance to carry out the duty thus imposed upon them.[3]

So also, if improvements on a river made by statutory authority benefit the railroad property among others, the trustees are liable to be assessed for a proportionate share of the expenses.[4]

§ 302. **Liability of the Company while the Trustees are in Possession.** — The liability of the trustees under such circumstances would seem necessarily to involve a complete exemption from liability on the part of the corporation itself, which has no longer the right or the power to control the property, and cannot be brought within the reach of the principle that the burdens of the position must be borne by one who enjoys its advantages. This doctrine has been adopted in a case in which the corporation was held not liable under a statute requiring the payment of damages to the "widow and family of a person whose life is lost by the negligence of servants or agents in the operation of the road."[5]

words showed that they were to be treated as a form of expression indicating that the defendants had become substitutes for the lessees.

[1] Rogers *v.* Wheeler (1871), 43 N. Y. 598.

[2] Lamphear *v.* Buckingham (1866), 33 Conn. 237; Stratton *v.* European & North American Ry. Co. (1884), 76 Me. 269; s. c. 17 Am. & Eng. R. R. Cas. 277; Farrell *v.* Union Trust Co. (1883), 77 Mo. 475; s. c. 13 Am. & Eng. R. R. Cas. 352; Cooley *v.* Brainerd (1866), 38 Vt. 394.

[3] Jones *v.* Seligman (1880), 81 N. Y. 190; s. c. 3 Am. & Eng. R. R. Cas. 236.

[4] County Commrs. of Hampshire, Petitioners (1887), 143 Mass. 424; s. c. 9 N. E. Rep. 756.

[5] State *v.* Consolidated European & North American Ry. Co. (1878), 67 Me. 479.

But another view has also been taken, and it has been held that, where the trustees are exercising the same functions as the corporation which has selected them, and are operating the road to earn money to pay the debts of that corporation, the trustees will be regarded as the agents of the corporation so far as relates to the transaction of business with third persons, and such persons may sue the corporation directly and recover for damages, in respect to transactions had with the trustees.[1]

§ 303. **Fiduciary Position of Trustee, Acts inconsistent with.**— The trustee in possession, as he is thus considered to occupy a fiduciary position with regard to the debtor and the creditor, is forbidden by the ordinary principles of equity applicable to such a position to deal with the property under his control in such a manner as to place his individual interests in a state of antagonism with those of either the bondholders or the makers of the bonds. Thus, although there is no rule of law which incapacitates him from purchasing and holding the bonds,[2] he will not be permitted to speculate in them for his private advantage, and for any profits which accrue from a rise in the value of the securities he will be compelled to account to the company.[3]

[1] Grand Tower Manufacturing & Transportation Co. *v.* Ullman (1878), 89 Ill. 244. Here the company was held liable, as a common carrier, for the destruction of goods by fire. No reason except the position of agency for the company occupied by the trustees is given by the court for this ruling, which is difficult to reconcile with the cases cited already in this and the two preceding sections, or with a previous decision of the same court in which the trustee's property was required to answer in damages for a personal injury, although they had carried on the business of the road in the name of the company. Wilkinson *et al.* Trustees, etc. *v.* Fleming (1863), 30 Ill. 353.

[2] Clark *v.* Flint & Pere Marquette Ry. Co. (1875), 5 Hun, 556; Ashuelot Ry. Co. *v.* Elliot (1874), 57 N. H. 397; s. c. 13 Am. Ry. Rep. 491, per Foster, C. J.

[3] Ashuelot Ry. Co. *v.* Elliot (1874), 57 N. H. 397; s. c. 13 Am. Ry. Rep. 491. There the reasons for applying the general rule in this case were explained as follows by Ladd, J., who delivered the principal opinion: "It is true, as the defendant says, that the legal liability of the corporation on the bonds has all the time been to pay their full amount with interest to the holders. It is at the same time true that, when the bonds are selling in the market or otherwise at fifty cents on a dollar, the debt might be extinguished by the corporation for one-half the amount they are legally liable to pay. The actual value of the bonds was all the time [*i. e.* while they were outstanding] measured by the amount for which they could be sold, and this would depend upon the understood ability of the company eventually to pay them in full. Now, when Mr. Elliot [the trustee], after he had taken possession of the road under the mortgage, became the owner of $46,000 of the bonds secured thereby, his individual interest lay strongly in the direction of enhancing their salable value, and so of increasing the amount for which the corporation might procure the extinguishment of the debt and remove the mortgage. The master finds that his buying up of the bonds was in part the cause of advancing their price from about fifty per cent. to about par. His duty did not call for any such private speculation for such a

Nor can he make a valid contract for the lease of the road to another corporation in which he is a stockholder and director.[1]

It constitutes no breach of trust for a trust company, under a mortgage of one corporation covering its property and stock (the controlling share) of another corporation, for the trustee to accept from this second corporation a mortgage upon its property, to secure bonds issued and turned over to the trust company to be used as a collateral to secure a debt owed by this second corporation to the first, the transaction being for the benefit of the bondholders.[2]

§ 304. **Trustee not compelled to countersign and deliver Bonds.** — The trustee of the mortgage in whose possession bonds are, cannot be compelled at the suit of a creditor of the corporation to issue the bonds of the corporation.[3]

purpose; and even though it should be said that a legal wrong was not thereby done to the mortgagors, inasmuch as their undertaking was to pay the full face of the bonds, the proceeding, nevertheless, strikes my mind as quite inconsistent, in an equitable point of view, with the relation of confidence and trust in which he stood to them. The reasons for scrutinizing with considerable care the acts of one situated as this trustee was, and applying the equitable rules relative to the conduct of trustees with a reasonable degree of strictness, seem to me, indeed, strong and imperative. He has the whole control and management of the road. His position necessarily gives him means of knowing its present resources and future prospects possessed by no one else. By accepting that position he assumed obligations to all the real parties in interest altogether inconsistent, as it seems to me, with the interposition of any private or personal interest of his own. With respect to the duties thus voluntarily assumed, the individual was absorbed, as it were, in the trustee. The interest of the corporation, which he was bound to protect so far as he could without infringing the legal rights of the bondholders (also in his keeping), lay in the direction of extinguishing the debt. In his relative capacity he represented the debtor and creditor both. A purchase of bonds by him on behalf of the corporation would be an extinguishment of the debt *pro tanto*. In doing that he would not be buying of his *cestuis que trust*, because as an individual he would represent the debtor. If, as an individual, he may buy the bonds, that would be, in the first place, a purchase by a trustee of his *cestuis que trust*, and, in the second place, would to that extent change his position from that of a trustee with no interest but to preserve the just and legal rights of both debtor and creditor, to that of the creditor having in his control and management the property of the debtor."

[1] Ashuelot R. Co. *v.* Elliot (1874), 57 N. H. 397; 13 Am. Ry. Rep. 491.

[2] Gasquet *v.* Fidelity Trust & Safety Vault Co. (1896), 75 Fed. Rep. 343.

[3] Eastern Electric Cable Co. *v.* Great Western Mfg. Co. (1895), 164 Mass. 274; 41 N. E. Rep. 295.

In England debentures are often certified to by the trustees, and the United States Mortgage and Trust Company of New York has recently originated a system of authentication of municipal bonds so as to guard against fraud, over-issue, etc.

Statutes of some of the States relating to trustees of railroad mortgages: Maine, Rev. Stats. 1883, ch. 51, §§ 85–90, Election, power, and duties of mortgage trustees; § 91, Foreclosure by trustees. Massachusetts, Pub. Stats. 1882, ch. 112, § 66, Power of trustees entitled to possession. Pennsylvania, Br. Purd. Dig. 1887, p. 1440, § 127, Liabilities of trustees in possession. S. C., Gen. Stats. 1882, § 1415, Liabilities of trustees in possession. Vt., Gen. Stats. 1894, §§ 3941 *et seq.*, Duties, etc. of trustees.

CHAPTER XIII.

STATUTORY LIENS IN FAVOR OF BONDHOLDERS.

§ 305. **Introductory.** — In the present chapter it is proposed to review the cases dealing with the rights of bondholders under statutes creating liens or mortgages (the terms are used indifferently by the courts)[1] in favor of a State to secure it for the loan of its credit to railroad companies. Such loans of the State credit are usually effected in one of two ways. Either the State guaranties the railroad bonds by indorsing them, or issues its own bonds to the company for negotiation. In the latter case it is usual to provide for a deposit in the State treasury of the railroads bonds to an amount equal to those issued by the State to the company.

The effect of the acceptance of the provisions of such statutes, therefore, is that the State occupies the position either of guarantor or principal debtor as regards the purchasers of the bonds negotiated by the company. Whether the lien reserved by the State can be enforced directly by the bondholders depends upon the construction of the statute itself, and each case must be decided in view of the terms of the particular statute. If the State has guarantied the railroad bonds by any words showing

[1] In some cases such liens are said to be substantially "in the nature of mortgages." McGraw *v.* Memphis & Ohio R. Co. (1868), 5 Coldw. (Tenn.) 434.

that the lien is created for the benefit not only of the State itself, but also of the bondholders, as will be seen below, the latter have a *locus standi* to apply to a court of equity for relief and to be subrogated to the rights of the State. If the loan of the State credit has been effected by the issuance of State bonds, the principle of subrogation cannot operate, and the action of the State is necessary to enable the bondholders to obtain the benefits of the lien, unless the effect of the statute is not simply the creation of a lien in favor of the State, but also a specific appropriation of some definite part of the property to the payment of the debt secured thereby.

§ 306. **When a Lien is deemed to have been created by the Statute.** — To create a statutory lien on the *corpus* or earnings of a railroad as a security for municipal or State aid, the expressions used in the statute must show clearly that it was the intention of the legislature to call the lien into existence. No such inference can be drawn from the fact that the companies accepted the State bonds issued in accordance with its provisions, thereby rendering themselves liable to the payment of a requisition, called in the statute a "tax," which was to be paid at stated times to the State treasurer, whose duty it was, in case of default in such payments, to sequester the revenues and hold them until the default had been fully paid up. Nor can a lien be created by implication from a section of such a statute providing that, upon the payment of this "taxation," the said road shall be entitled to a discharge from all "claims or liens" on the part of the State.[1]

[1] Tompkins *v.* Little Rock & Fort Smith Ry. Co. (1882), 15 Fed. Rep. 6; 18 Fed. Rep. 344 (1883); 21 Fed. Rep. 370 (1883); 125 U. S. 109 (1888). In this case a company receiving the bonds issued under the statute in question had executed a mortgage to secure its own bonds. This mortgage had been foreclosed, and the property sold subject to any lien of the State which might be declared to exist on account of the State-aid bonds, and the purchaser at the sale had organized a new company. Thereafter the State Supreme Court had declared the issue of their State-aid bonds unconstitutional and the bonds void. The holder of some of these bonds and coupons brought suit against this new company, alleging that there was a statutory lien under the acts in favor of the State to secure these bonds, and that they were entitled to be subrogated to the same in equity and have it enforced against the property. When the matter came up in the United States Circuit Court a demurrer to the bill was overruled, both the Circuit and the District Judges holding, upon the authority of Railroad Cos. *v.* Schutte (1880), 103 U. S. 118, that this act created a statutory mortgage on the roads, their income and revenues, to secure the payment of the State bonds by the companies accepting the loan; that all persons were bound to take notice of the lien reserved by the act, and when it occurred; that the lieu reserved to secure the payment of the bonds was financially a security for those holding the bonds; that, as between the State and the company receiving the bonds the company was the principal debtor,

Nor can an intention to create such a lien be deduced from the fact that, unless the particular clause of the act relied on is oper-

and bound to pay the bonds or pay to the State money for that purpose; that, if the bonds were void as obligations against the State, the company which received and negotiated them as genuine was bound to pay them to *bona fide* holders; and that the latter might, therefore, enforce the lien reserved by the act to secure this result. Upon final hearing the bill was dismissed in conformity with the opinion of Miller, Circuit Justice, in which he held that there was nothing in the bonds themselves, without indorsement by the companies, to bind those that received and sold them to pay either the principal or interest; that the holder of the bonds, though the latter might be void as to the State, would be entitled to such remedy as the statute gave against any railroad companies which had accepted and sold the bonds, and thereby ratified the remedies provided by the statute; but that there was nothing in the act which would constitute a statutory lien for the benefit of those bondholders, or against the railroad property itself. Caldwell, District Judge, adhered to his former opinion.

Upon appeal to the Supreme Court the decision of Justice Miller was upheld. In the course of his opinion Waite, C. J., said: "The bonds were bonds of the State, pure and simple; they carried on their face no express obligation of the railroad company to the holder. The promise made by the company on the acceptance of the bonds was to pay the State, not the bondholder. The failure of the company to meet its obligations to the State did not operate in any manner to relieve the State from its liability on the bonds. The debt of the State still remains, and was the only debt the bonds expressed on their face. The debt of the company was to the State for the bond, not to the bondholder on the bond, payment of which to the State discharged the obligation of the company. If these bonds were invalid, and relief was sought on that account against the company selling them, the liability would not be on the bonds, but for the money had and received on their sale; that certainly would be the debt of the original company alone, and in no way binding on a purchaser of its property."

The distinction between the case before the court and those of Railroad Cos. *v.* Schutte (1880), 103 U. S. 118, and Ketchum *v.* St. Louis (1880), 101 U. S. 306, was then pointed out. "The facts of the latter showed a complete equitable assignment of the fund in question, while in the present one there was no specific appropriation of the earnings of the road. The company was required to pay what was called the 'tax,' to enable the State to meet the semi-annual instalments of interest on the State bonds, and provide a fund for the redemption of the principal whenever it falls due. No specific amount of the earnings of the road was specially set apart by law for that purpose. There was no provision for a custodian of the earnings, whose duty it shall be to pay the State, *out of the earnings* as they accrue, any definite amount on the days named. The tax is to be paid by the company on certain specific days, but there is no statutory appropriation of earnings for that purpose. If the company fails to meet the 'tax' as it falls due, the income and revenues of the 'said company' may be sequestered. Under the operation of this sequestration the receiver to be appointed may take possession of all the income and revenue of said defaulting company, with authority to demand and receive all moneys coming to the same from the operation of such road; but this falls very far short of a specific appropriation of the earnings of the road as they accrue, so that they can be demanded under the statute as earnings of the road, without sequestration." The learned Chief Justice, while admitting the propriety of considering the intention to charge the property with a lien, and the duty of the court of equity to use its power to enforce such charge, and to put a liberal construction on such statutes, with a view to establish such charges against the companies and in favor of the State, thus concluded: "The wide departure which Arkansas made in this statute from the accustomed form of proceeding, both at home and elsewhere, is strongly indica-

ative for this purpose, it will be merely declaratory of the law as it was already; especially when the result of such a construction would be to make another clause in the same section devoid of meaning.[1] Nor do bonds issued in pursuance of an act providing that they "shall be binding upon the property of the company, and on such other property belonging to the stockholders as they may pledge to the company by mortgage, to meet their own engagements or the engagements of the company," become *ipso facto* a lien on the property superior to other bonds, secured by a later trust deed, and held by persons who have no notice of the lien.[2]

It is not, however, necessary that the legislative intention to call the lien into existence should be expressed in direct words. Thus where the issue of a county's bonds to a railroad company and the appropriation of the income of the road to the payment of the interest and principal of the bonds are authorized by a

tive of an intention to waive security any further than it was embraced in the reserved power of sequestration. . . . In our opinion the new companies took the roads free of incumbrance in favor of the State, and neither the State nor its bondholders are entitled to a sequestration of the income and revenue arising therefrom in their hands." This statute was again under discussion in the recent case of McKittrick *v.* Arkansas Central Ry. Co. (1894), 152 U. S. 473; s. c. 14 Sup. Ct. Rep. 661, and the court adhered to its former opinion.

[1] Cincinnati City *v.* Morgan (1865), 3 Wall. 275. Here the act authorizing the City Council of Cincinnati to issue its bonds to a railroad contained the following section: "It shall be the duty of the said City Council . . to secure by mortgages, transfers, or *hypothecations of stock* of said company, *or* by such *other liens or securities* as may be mutually agreed upon, the payment of the principal as it may become due, and the reimbursement of the interest on the same which shall have been paid by the city; and, for the further purpose of securing the city against all losses, whether by the payment of the said principal or interest, the above-described liens, etc., shall have precedence of all claims or obligations subsequently contracted by the company, and over other liens, securities, or mortgages which were not duly entered into before the respective loans and issues aforesaid." The court said: "The first clause of this section would be quite as idle and absurd a piece of legislation, which conferred on the parties the authority of agreeing on their own terms as to the nature and character of the security, for the loans, as the latter, if by the latter clause, whatever might be the security agreed upon, it must operate as a mortgage on the road, and have precedence over all others. Why give this choice of security if this would be the result? There was no necessity to stipulate for a mortgage on the road if the statute gave the lien without it; nor propriety or sense in the choice between a mortgage and a pledge of stock, if a lien on the road followed either security."

[2] Brunswick & Albany R. Co. *v.* Hughes (1874), 52 Ga. 557; s. c. 7 Am. Ry. Rep. 137, distinguishing Collins *v.* Central Bank, 1 Kelly (Ga.), 435, where, by the statute, the corporate property was to be "pledged and bound" for the redemption of certain bills to be issued by the bank. The court emphasized both the stronger terms by which the lien was created in the earlier case, and the different nature and character of the two debts. The bonds were an ordinary debt; the bills were issued for circulation among the people of the State, and formed a part of the currency.

statute, the acceptance of the terms specified in the statute, and the issue of the county bonds in accordance with its provisions, were held to operate as a contract by which the company agreed that the official who was to receive the earnings should pay the sums necessary to defray the interest on the bonds ; and the effect of this contract is the creation of a lien of an equitable nature upon the earnings as they accrued, and this lien is enforceable as long as the bonds are unpaid.[1]

§ 307. **Construction of Statutory Mortgages.** — As regards the property covered, a statutory lien or mortgage is constructed according to the same principles as an ordinary trust deed or mortgage. If the words used in the statute are such that they would, in a trust deed or mortgage, be deemed to cover the whole

[1] Ketchum *v.* Pacific Railroad (1877), 4 Dill. 78, affirmed in Ketchum *v.* St. Louis (1880), 101 U. S. 306.

The legislature of Missouri had, between the years 1851 and 1855, passed various acts loaning the credit of the State to aid and secure the completion of the Pacific Railroad. This aid was given in the shape of bonds, the State being secured by a statute lien with a power of sale. The work of construction was suspended by the Civil War, but in 1864 another act was passed authorizing the company to borrow $1,500,000 to complete the road. This loan was to be secured by a first lien on a portion of the line, the State waiving its prior lien to this extent. By this act a fund commissioner was appointed, who was to have control of all the revenues of the company, which were to be applied, after all expenses of operation, etc., had been paid, in the following order: (1) To his salary; (2) To liquidate the interest on the first-mortgage bonds for which the act provided ; (3) To the dividends on the preferred stock which the same act authorized to be created. The surplus, if any, was to be applied to the purchase of outstanding State bonds. The money was obtained, but while the work was in progress the line was "raided" by the insurgent forces, and further aid was needed, both to repair the damage thus inflicted and to finish the line. In this emergency the legislature authorized the County of St. Louis to loan its credit or bonds for this purpose. It was provided in this act that the county should have a lien upon the earnings of the company in the hands of the fund commissioner, or any other person, to secure the undertaking of the company to pay the interest and principal of these county bonds as they matured. The provisions of the statute were accepted by the company, and the bonds of the county were issued to it.

When a subsequently executed mortgage was foreclosed, a question of priority of lien as to the earnings arose. The court said, referring to the terms of the act: "Such appropriation and waiver were, by agreement of all the parties then interested in the property and the disposition of its income, to continue until the bonds themselves were paid, or the county discharged from liability thereon. It was not a simple, naked covenant to pay out of a particular fund; but the act, being accepted by the parties interested, operated as an equitable assignment of a fixed portion of that fund, — an assignment which became effectual without any further intervention upon the part of the debtor, and which the party holding the funds of the company, whether the fund commissioner or some other person, could respect without liability to the debtor for so doing. . . . It was an engagement to pay out of a specially designated fund, accompanied by express authority to its custodian to apply a specific part thereof to a definite object in the accomplishment of which all the parties to the arrangement were directly interested."

property of the company, including after-acquired property, the statutory lien will be equally extensive. This result is not changed by the fact that a portion of the road may have already been built, before that particular section, upon the completion of which the indorsement is authorized to be made.[1]

§ 308. **Waiver of the Benefit of a Statutory Lien by the State.** — As between itself and subsequent incumbrancers the State is deemed to have waived its statutory lien by authorizing the company to issue bonds, and secure them by mortgages on the road, if the enabling acts contain no intimation that such liens were to be subject to the prior lien of the State.[2]

§ 309. **Release of Statutory Lien.** — Where the assignment of a statutory State lien to a company is authorized upon the payment to the State treasurer of a sum of money equal in amount to all indebtedness due or owing by the company to the State, and all liability incurred by the State by reason of having issued bonds and loaned the same to the company, together with all interest that has, or may have, at the time when such payment shall have been made, accrued and remained unpaid by the company, the lien of the State remains enforceable until payment has been made not only of the face value of the bonds, but also of all outstanding coupons which are, or have been, attached to the bonds, whether due or not, together with all indebtedness due or owing by the company to the State by reason of the latter's having issued its bonds, or paid interest thereon.[3]

The same act was also discussed in the Supreme Court of Missouri, and the petition of the trustees for a *mandamus* to the treasurer directing him to assign the lien was denied, on the ground that, even if the act had the meaning contended for, viz., that they were not obliged, as a prerequisite to the assignment,

[1] Colt *v.* Barnes (1879), 64 Ala. 108. Compare Chap. IX.

[2] Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush (Ky.), 673; Brown *v.* State of Maryland (1884), 62 Md. 439. In the latter case it was observed: "In the ordinary affairs of life, if an individual who has a lien on property authorizes a mortgage of it for the purpose of raising money, it would be inferred that he intended his lien to be subordinated to the mortgage. But suppose his lien exceeded the value of the property, and that the money to be obtained by the mortgage was to be expended in improving it, the inference would amount to certainty."

[3] Ralston *v.* Crittenden (1882), 10 Fed. Rep. 254. Coupons, it was observed, are obligations capable of a distinct suit, and so far separate obligations from the bonds. As long as such pieces of paper were outstanding, they were each an item of debt owing at the time this transaction occurred. Whatever the State had become liable for, under the issue of those bonds, was to be paid by a sum of money equal to it if paid in money, before the right to the assignment of the statutory lien accrued. This had not been done.

to provide for the future interest, any such construction would make it repugnant to a subsequent constitutional provision forbidding the legislature to release or alienate a State lien on any railroad, and as no vested rights were created by the mere passage of the act, and its proposals had not been accepted until after the adoption of the constitution, it ceased to operate as soon as that event occurred.[1]

On the other hand a constitutional provision that the legislature shall have no power for any purpose whatever to *release* the lien held by the State upon any railroad, does not prevent that legislature from discharging its lien on receiving the full value of the security, the legislature itself being the judge of what the full value is.[2]

§ 310. **Remedies of Bondholders for the Enforcement of Statutory Liens.**[3] — When the State indorses railroad bonds, and reserves by statute a lien upon the property of the company for its own indemnification, the presumption is that the lien so reserved is for the protection and benefit not only of the State itself, but also of the persons who take the bonds relying upon the guaranty of the State.[4]

1 The State *ex rel.* Rolston *et al.* Trustees *v.* Chappell (1881), 74 Mo. 336.

2 Murdock *v.* Woodson (1873), 2 Dill. 188; affirmed in Woodson *v.* Murdock (1874), 22 Wall. 351.

3 As to the remedies for the enforcement of the lien of ordinary mortgages or trust deeds, see *post*.

4 Hand *v.* Savannah & Charleston R. Co. (1879), 12 S. C. N. S. 314. In this case it was contended that the language of the statute vesting a lien in the State upon its indorsing the bonds of a railroad company, and making no mention of bondholders, implied that it was the intention of the legislature to hold the lien for its own benefit. In discussing this theory the court made the following remarks: "In the payment of the bonds and interest, not only the State but the bondholders were interested; and if security is given for the performance of a particular act, why should it not inure to all interested in the performance of the act, whose interests were the subject of consideration and protection in the transaction that gave origin to the security? If a private individual had stood in the place of the State, and the terms of the act had been the terms of a private contract, there can be no doubt that as such contract, in effect, created the rights of the bondholders, such as might on the contingency contemplated arise, such terms would be held to amount to a declaration of trust in favor of the after-springing rights of the bondholders, and the surety could not be regarded as holding, subject merely to a general equity of subrogation. There was nothing to prevent the title acquired by the State in the lien or mortgage from passing under the operation of the same directly to and vesting in the bondholder, according to the extent of his interest, and therefore there was no inconsistency in creating a lien, attached to a bond, that may pass from hand to hand, and vesting that lien in the State." The court then commented on the language of the act as follows: "The intention is clearly expressed that the security taken shall be for the payment of the bonds. It is in no case said that it is taken for the special indemnity of the State as indorser. That is undoubtedly implied, but the direct provision is for the payment of the bonds. A provision for the payment of the bonds is primarily a security for those holding the bonds.

Such statutes usually provide special remedies for the enforcement of the lien by the agents of the State, and it is only the State itself that can use these remedies.[1]

But if the State fails to put those remedies in motion, the bondholders may apply to a court of equity for relief, and thus avail themselves of the existence of the lien created for their benefit,[2] unless there is some express provision in the statute that the remedies given by it are to be exclusive.[3]

Where a railroad company issues bonds which, in accordance with the provisions of a statute, are guarantied by the trustees of an internal improvement fund, and a subsequent statute makes those bonds a first lien on the corporate property, the bondholder has, in addition to the personal liability of the company, two securities; viz., the guaranty of the improvement fund, and the statutory lien.[4]

But the bondholders cannot avail themselves of the lien as if it were a mortgage given to secure the bonds alone. They must induce the trustees of the guaranty fund to act in the mode pointed out. If they refuse to act when they ought to do so, the bondholders may either compel them to act by *mandamus*, or file a bill in equity to obtain the relief to which they may be entitled.[5]

It is always so in equity and at law when its forms permit it." This reasoning was approved by the same court in Gibbes *v.* Greenville & Columbia R. Co. (1880), 13 S. C. N. S. 228; s. c. 4 Am. & Eng. R. R. Cas. 459.

[1] Forrest's Exrs. *v.* Luddington (1883), 68 Ala. 1; s. c. 12 Am. & Eng. R. R. Cas. 330. In this case the court thought it was also incontestable that the State itself was not restricted to the statutory remedy, but might resort, if such a course was deemed preferable, to a court of equity, and have the lien enforced by the ordinary methods of chancery. This *obiter dictum* is supported by State of Florida *v.* Florida Central R. Co. (1876), 15 Fla. 690, where it was held that, if there is a trust and a mortgage, and connected with them, in order to secure their due enforcement, there is a statutory power of sale, a court of equity, at the suit of the trustee, might decree a sale conformably to the statutory power.

[2] Forrest's Exrs. *v.* Luddington (1883), 68 Ala. 1; s. c. 12 Am. & Eng. R. R. Cas. 330.

[3] State *v.* Florida Central R. Co. (1876), 15 Fla. 690.

[4] Florida *v.* Anderson (1875), 91 U. S. 667.

[5] Florida *v.* Anderson (1875), 91 U. S. 667. Compare Schutte *v.* Florida Central R. Co. (1879), 3 Woods, 692. At the time the former of these suits was instituted the road had passed into the hands of the purchasers at the sale under a foreclosure against the company to which the bonds were originally issued. A portion of the purchase-money had been paid, and with this a corresponding amount of the bonds had been retired. The holders of the residue contended that their bonds were still a first lien on the road, notwithstanding the trustees' sale, and that, at all events, they were entitled to prosecute the lien for the unpaid purchase-money due on that sale in order to obtain satisfaction of their bonds, and to do so by right paramount to that of the State or trustees to enforce the vendor's lien for the unpaid purchase-money. The court, however, said that, as the lien was a statutory one, it could only be enforced in the

§ 311. **Condition for the Benefit of the State in the Enabling Act can only be taken Advantage of by the State.**— An act by which the State empowers the company to borrow money upon its consenting to recognize. certain State-aid bonds as a part of its floating debt, does not create the relation of debtor and creditor between the company and the bondholders who were not parties to the transaction, or give them any right of action against the company.[1]

§ 312. **Subrogation of Bondholders to the Rights of the State.** — As already stated, the right of bondholders to enforce statutory liens declared to indemnify the State for its indorsement of railroad bonds depends upon the principle of subrogation. This term as used in this connection has a wider signification than that which it ordinarily bears in respect to mortgages; viz., the right which arises when the mortgage debt has been extinguished by any other than the party entitled to redeem. In most of the cases on the subject the bondholders have been seeking to enforce the lien while the debt was still in existence, and their claims to be subrogated to the lien declared in favor of the State depend rather upon the broad principle that a creditor is entitled to the benefit of all pledges and securities, given to or in the hands of a surety for his indemnity, and this whether the surety is damnified or not, such pledges and securities being regarded as a trust created for the better security of the debt.[2]

"The right of the creditor arises from the natural justice of allowing him to have applied to the discharge of his demand the property deposited with the surety for that purpose, if required by the default of the principal." [3]

The operation of the principle of subrogation is not affected by the rule that the State cannot be made a party to a suit in a federal court, and refuses to be a party in any other court. The

manner pointed out by the statute. The primary right to proceed against the property being in the trustees, and they having exercised that right with the result of being able to extinguish a portion of the bonds with money realized by the foreclosure sale, the original lien of the bonds was consummated and merged in the title acquired by the purchasers at that sale. The holders of the outstanding bonds, therefore, had no right to interfere with the proceedings instituted by the State or the trustees for the enforcement of their vendor's lien, and might properly be enjoined from any such action. A useful note on the points raised in this case will be found in the note appended to the report of it in 3 Am. & Eng. R. R. Cas., p. 25 ff. Compare also State *v.* Florida Central R. Co. (1876), 15 Fla. 690.

[1] Stuart *v.* James River & Kanawha Co. (1874), 24 Gratt. 294.

[2] Colt *v.* Barnes (1879), 64 Ala. 108; s. c. 7 Am. & Eng. R. R. Cas. 129. Compare the language of the same court in Forrest's Exrs. *v.* Luddington (1883), 68 Ala. 1; s. c. 12 Am. & Eng. R. R. Cas. 330.

[3] Chamberlain *v.* St. Paul & Sioux City R. Co. (1876), 92 U. S. 299, per Justice Field.

law of subrogation being the creation of equity, and resorted to to prevent a failure of justice, a court of equity would be guilty of a singular inconsistency if it should deny the right of subrogation for such a reason.[1] But there can be no subrogation except as to the bonds actually indorsed by the State.[2]

And if some of an issue are indorsed, and others are not, the holders of the former are entitled to be paid before the holders of the latter out of the proceeds of a sale made by virtue of a decree in proceedings to foreclose a mortgage executed by the company to secure the bonds, and expressed upon its face to be subordinate to the statutory lien.[3]

Subrogation being a strictly equitable doctrine, creditors who seek the enforcement of the claims by being subrogated to the rights of the State must submit to the operation of the equitable principle that "equality is equity." The holders of the bonds, therefore, are entitled to share equally with the holders of past-due coupons in the proceeds of a sale made under a decree foreclosing the statutory lien.[4]

§ 313. **Right of Holders of State Bonds negotiated by Company to enforce Lien declared in Favor of the State.** — When the loan of the State's credit is made by issue of State bonds to the railroad company, the State is, as regards the bondholder, the principal debtor, and the company the surety. In such a case the company by negotiating the bonds is liable under the rule that makes every indorser of commercial paper the guarantor of the genuineness and validity of the instrument he indorses.[5]

But the relations of the parties do not admit of the application of the doctrine of subrogation in favor of the bondholders. Their right to enforce the lien of the State to secure payment of its bonds depends upon the words of the statute creating that lien. If that lien is made a security for the bondholders, they have their own recourse thereon.[6] So also, if there is by the statute a specific appropriation of a definite portion of the company's property, into whosesoever hands it may come, and it will be the duty of a court of equity to do everything in its power to enforce that charge.[7]

[1] Young *v.* Montgomery & Eufaula R. Co. (1875), 2 Woods, 606.

[2] Clews & Co. *v.* First Mortgage Bondholders of the Brunswick & Albany R. Co. (1875), 54 Ga. 315.

[3] Colt *v.* Barnes (1879), 64 Ala. 108; s. c. 7 Am. & Eng. R. R. Cas. 129.

[4] State *v.* Spartanburg & Union R. Co. (1874), 8 S. C. 129.

[5] Railroad Cos. *v.* Schutte (1880), 103 U. S. 118; s. c. 3 Am. & Eng. R. R. Cas. 1.

[6] Ibid.

[7] Ketchum *v.* St. Louis (1879), 101 U. S. 306, explained and distinguished in Tompkins *v.* Little Rock & Fort Smith Ry. Co. (1888), 125 U. S. 117, from which several extracts were given in the note above.

On the other hand, where a company, in accordance with the provision of a statute authorizing a loan of State bonds, mortgages to the State certain lands, as an indemnity against loss thereon, and after purchasing those bonds at a foreclosure sale sells them to other companies, the bondholders have no equity for the application of the land to the payment of the bonds which can be enforced against the State, and the grantees take the property discharged of any claim of the bondholders.[1]

§ 314. **Unconstitutionality of Part of Act authorizing Issue of State Bonds not a Bar to Enforcement of Lien by Bondholders.** — If the intention of the legislature is clearly expressed that the debt contracted on the combined credit of the company and the State shall be a lien on the railroad property, even the unconstitutionality of that portion of the act which authorizes the execution of State bonds, and their exchange for railroad bonds, will not necessarily be fatal to the validity of the portion which creates the lien. That portion will still be upheld, if, after striking out all that is invalid, it is possible to give effect to what appears, upon a consideration of the whole enactment, to have been the legislative will. The result in this case is to avoid the bonds as State obligations, and to leave them good against the company which actually put them out.[2]

[1] Chamberlain *v.* St. Paul & Sioux City R. Co. (1875), 92 U. S. 299. It was contended by the counsel for the bondholders that, notwithstanding the form of the contract, the company was in fact the principal debtor, and the State its surety, thus bringing the case under the rule illustrated in the preceding section. The court disposed of this theory as follows: "In this case the deed and mortgage were not intended to create a trust in favor of the holders of her own bonds. The State was primarily liable to the bondholders, and it was only as between her and the company that the relation of principal and surety existed. It may be doubted whether the bondholders could call on the company in any event. The indorsement made by the president simply transferred the bonds; it was not the act of the company. Be that as it may, whatever right the plaintiff had to compel the application of the bonds received by the State to the payment of the bonds held by him, it was one resting in equity only. It was not a legal right arising out of any positive law or any agreement of the parties. It did not create any lien which attached to and followed the property. It was a right to be enforced, if at all, only by a court of chancery against the surety. But the State being the surety here, it could not be enforced at all, and, not being a specific lien on the property, cannot be enforced against the State's grantees. (Strong, J., dissented.)

[2] Railroad Companies *v.* Schutte (1880), 103 U. S. 118; s. c. 3 Am. & Eng. R. R. Cas. 1, especially p. 142. The court thought it clear that "the object of the legislature was, not to create a debt which the State was expected to pay, but to aid the company in borrowing money on the credit of the State," and laid stress upon the fact that, "in any event, the company was to be bound for the payment of the entire debt when it matured, and its property was to be given as security." Under these circumstances "the unconstitutional part of the statute might be stricken out, and the obligation of the company, including its statutory mortgage in favor of the holders of the State bonds,

§ 315. **Effect of Subsequent Legislation on the Rights of Bondholders secured by a Statutory Lien.** — A statutory lien created for the benefit both of the State which indorses railroad bonds and of those who take such bonds relying on the guaranty by the State itself (see Chap. IV., above), cannot be postponed or in any way impaired by a subsequent statute.[1]

Where a later act is passed purporting to extend the original lien so as to cover an additional issue of bonds, and at the same time offering certain advantages to persons holding bonds under the provisions of the first act, if they will surrender their bonds for an equal amount of the new issue, those who come under this provision must take the new bonds on the conditions on which they are offered. *Qui sentit commodum, sentire debet et onus.* The bonds issued under the first act and never passed under the second act will have priority and take rank from the date of the former act. The rights of those holding bonds which have so passed under the second act will be no more than they can claim by virtue of that act.[2]

But if it appears from a consideration of the whole act that the lien with which the State is to be invested was created to secure payment to the State of the amount of indebtedness it undertook to incur by issuing its aid bonds, and not payment to the holders of those bonds, the State can accept payment of the bonds in other modes than those pointed out by the statute creating the lien, and can cause the property to be released from it, either by legislation or by foreclosure under the statute, while the bonds issued to the company for the construction of the road are still outstanding and unpaid.[3]

If a mortgage is made subject to a special reservation that, whenever a certain State loan should be obtained, and bonds

left in full force." The effect of the same act as the one under which the bonds in this case were issued was largely discussed in Florida *v.* Anderson, 91 U. S. 667. The question of its unconstitutionality was not passed upon, the court saying that, in a suit which was merely ancillary to proceedings in the State courts, such a question should be left for the latter to determine.

[1] Hand *v.* Savannah & Charleston R. Co. (1879), 12 S. C. 313; Gibbes *v.* Greenville & Columbia R. Co. (1880), 13 S. C. 228; s. c. 4 Am. & Eng. R. R. Cas. 459.

[2] Gibbes *v.* Greenville & Columbia R. Co. (1880), 13 S. C. 228; s. c. 4 Am. & Eng. R. R. Cas. 459.

[3] Tennessee Bond Cases (1885), 114 U. S. 663 (Harlan, J., dissenting). The court distinguished them from the cases like Hand *v.* Savannah & Charleston R. Co. (1879), 12 S. C. 314, where the primary liability for the payment of the bonds rests on the company, and the State is bound only as a surety, and laid great stress upon the principle that "contracts created by, or entered into under, the authority of statutes are to be interpreted according to the language used in each particular case to express the obligation assumed."

executed to secure the payment thereof, those bonds should have priority over the mortgage, a subsequent statute authorizing the company to mortgage the unfinished portion of the road, on condition of relinquishing all claims to the State loan so far as that section of the road is concerned, is to be construed merely as a permission given to the company to substitute some other lender in the place of the State. A creditor lending in pursuance of that statute is, therefore, subrogated to the right of the State as respects the priority of its prospective lien, and takes precedence of the bondholders secured by the first mortgage so far as the unfinished section of the road is concerned. Such a statute cannot be objected to on the grounds of unconstitutionality, even though there are some variations between the stipulations of the first issue of bonds and of the second, provided the essential elements of the transaction are left unaffected. The controlling, substantial agreement between the company and the first bondholders was that the State should furnish a loan, and that this loan was to be a first lien. All the rest was matter of detail between the company and the State, of no particular concern to the bondholders.[1]

[1] Campbell *v.* Tex. & N. O. R. Co. (1872), 2 Woods, 263; s. c. 4 Fed. Cas. 1188, Case No. 2369.

CHAPTER XIV.

ROLLING-STOCK AND CAR TRUSTS.

Article I. — Whether Rolling-stock is a Fixture.

§ 316. **The Authorities are irreconcilably conflicting** in regard to the question whether rolling-stock is a fixture or not, — that is, there is no uniformity in the holdings on this point, and the law differs in different States, so that there is a diversity of view as to the applicability of chattel-mortgage acts to rolling-stock. In treating the subject, therefore, statement is made of the result of the decisions in some of the principal States where the question has been raised.

§ 317. **Doctrine in New York.** — In New York, when this question first presented itself, it was held by the Supreme Court that

locomotives and cars were covered by a mortgage of the road and real estate generally of the company.[1]

Stress was laid upon the fact that personalty need not necessarily be stationary to be a fixture in the technical sense, and reference made to the common-law rule that pigeons in a pigeon-house, deer in a park, and fish in an artificial pond, are deemed fixtures. "That railway cars," said Strong, J., "are a necessary part of the entire establishment, without which it would be inoperative and valueless, there can, of course, be no doubt. Their wheels are fitted to the rails; they are constantly on the rails, and, except in cases of accidents or when taken off for repairs, nowhere else; they are not moved off the land belonging to the company; they are peculiarly adapted to the use of the railway, and in fact cannot be applied to any other purpose; they are not, like farming utensils, and possibly the machinery in factories, and many of the movable appliances in stores and dwellings, the objects of general trade; they are permanently used on the particular road where they are employed, and seldom, if ever, changed to any other. Many of these are strong characteristics of the realty; some of them have often been deemed conclusive." This view did not long remain unquestioned, and two years afterwards the Supreme Court ruled that rolling-stock was personalty.[2]

The question was finally settled in New York by a decision in the Court of Appeals to the effect that rolling-stock was personalty.[3]

[1] Farmers' Loan & Trust Co. *v.* Hendrickson (1857), 25 Barb. 484.

[2] Buffalo *v.* Buffalo & New York City R. Co. (1858), 31 Barb. 590; Beardsley *v.* Ontario Bank (1859), 31 Barb. 619. In the former case Judge Grover, in his concurring opinion, reviewed the several grounds on which Judge Strong had based his decision in Farmers' Loan & Trust Co. *v.* Hendrickson, and concluded that they were inadequate to sustain it. Much emphasis was laid on the fact that railway cars are frequently on other lines and constantly shifting their position, and therefore did not correspond with the leading idea of a fixture; viz., that "it is something affixed to land, or to buildings on the land; something fixed, permanent in its location, or a mere incident to something so fixed."

[3] Hoyle *v.* Plattsburgh & Montreal R. Co. (1873), 54 N. Y. 314; s. c. 7 Am. Ry. Rep. 283, reversing the decision in the Supreme Court, which had returned to its earlier opinion. It was said that, to constitute personal property a fixture, some element of annexation, usually physical, must be present. Cases of constructive annexation were few, and rested on peculiar reasons of their own. In all of them there existed both adaptation to the enjoyment of the land, and localization in use as obvious elements of distinction from mere chattels personal. The court then proceeded thus: —

"Even in respect to cases of actual annexation to the realty and consequent change of character from chattel personal to realty, it is held that there ought to be the concurrence of actual annexation, of applicability to the use to which that part of the realty is appropriated with which it is connected, and, lastly, an intention on the part of the party making the annex-

§ 318. **Doctrine in New Jersey.** — In New Jersey the question was still an open one, in 1877, when it presented itself in Williamson *v.* New Jersey Southern R. Co.[1]

In the lower court the chancellor delivered an elaborate opinion asserting the doctrine that rolling-stock is realty; but this ruling was unanimously reversed by the Court of Errors and Appeals. The opinion rendered by Depue, J., contains an exhaustive and extremely careful review of the previous decisions; the conclusion that rolling-stock is not a fixture was finally rested on grounds very similar to those which commended themselves to the New York Court of Appeals. The difficulty of ascribing the attributes of realty to property which is so frequently disconnected from the road-bed of its owners and scattered over many different lines was strongly emphasized, as it had been in the sister court.

It has been ruled by a federal court sitting in New Jersey that the enactment of a supplement to the Chattel Mortgage Act, requiring certain additional formalities in the filing of a chattel mortgage, was not intended to affect the act which had placed railroad mortgages on a distinct and separate footing.[2]

§ 319. **Doctrine in Illinois.** — In Illinois rolling-stock was held in some early cases to be a fixture, whether on the authority of

ation to make a permanent accession to the freehold. Potter *v.* Cromwell (1869), 40 N. Y. 287; Voorhees *v.* McGinnis (1872), 48 id. 278. Looking now at the rolling-stock of a railroad, it is originally personal in its character, it is subservient to a mere personal trade, — the transportation of freight and passengers. The track exists for the use of the cars rather than the cars for the use of the track. There is no annexation, no immobility from weight; there is no localization in use. The only element on which an argument can be based to support the character of realty is adaptation to use, with and upon the track. Even in respect to this, were the same contrivance adopted by a tenant for use in his trade upon leased lands, his right to remove both cars and track would be beyond question. It is perhaps fortunate that this question was not finally adjudicated in the early days of railroad enterprise, for then unity of ownership in track and cars, and independence of roads upon each other, seemed to render it possible to consider rolling-stock part of the realty without introducing great inconvenience. At the present time independent companies exist, owning no tracks, whose trains run through State after State on the railroad track of other companies. It is no uncommon sight to see the cars of half a dozen companies formed into a single train and running from New York to Illinois and Missouri. It is impossible to deal with such property as part of the realty without introducing anomalies and uncertainties of the gravest character. Call cars and engines part of the realty; where shall they be taxed? Real estate is to be taxed at its site. What is the site of a railroad train running from New York to Buffalo in a day? Shall it be taxed in each town where the assessors catch sight of it rushing by at thirty miles an hour? Or, if a judgment be docketed in one county on the line, will its lien attach on each car as it is whirled past?"

[1] 28 N. J. Eq. 277; s. c. on appeal, 29 N. J. Eq. 311 (1878).

[2] Metropolitan Trust Co. *v.* Pennsylvania, S. & N. E. R. Co. (1885), 25 Fed. Rep. 760.

the first New York case referred to above or independently, it is impossible to say, as the court did not cite any authorities.[1]

Some years later the same court declined to express an opinion whether a mortgage of rolling-stock was subject to the provision of the Chattel Mortgage Act;[2] but when the question was squarely presented soon afterwards, laid down the doctrine that a mortgage comprehending the company's property of every description, both real and personal, and recorded in all the counties through which the road passed, created a valid lien on the personal property, although the instrument was not acknowledged as the Chattel Mortgage Act required.[3]

The same conclusion as regards that act had been arrived at two years earlier, and on somewhat similar grounds, by the Supreme Court of the United States.[4]

In this State the question is now no longer an open one, as it had been provided by the constitution of 1870 that rolling-stock is to be considered personal property.[5]

§ 320. **Doctrine in Alabama.** — In Alabama it has been held that rolling-stock is a chattel personal, not converted into realty by being put upon the railroad, and that liens attaching to it, when delivered to the company, will not thereby be displaced in favor of a prior mortgage upon the road and its equipments.[6]

[1] Palmer *v.* Forbes (1860), 23 Ill. 301. The question was dismissed very briefly, and the doctrine of constructive annexation was certainly carried very far in the ruling that materials provided for the repair of the track were also part of the real estate. This case was approved in Hunt *v.* Bullock (1860), 23 Ill. 320, and Titus *v.* Mabee (1861), 25 Ill. 257.

[2] Binkert *v.* Wabash Ry. Co. (1881), 98 Ill. 205; s. c. 58 Am. & Eng. R. R. Cas. 113.

[3] Cooper *v.* Corbin (1883), 105 Ill. 224. The reasons assigned for the decision were: (1) That the act required a mortgage of chattels to be recorded in the township in which the mortgagor resided, a provision quite inapplicable to a mortgagor owning a property like a railroad passing through numerous townships; (2) that under the act a chattel mortgage would run only two years, and therefore, if a railroad mortgage was to be governed by its provisions, the right to borrow money on long time, to construct or equip a road, would in effect be taken away; (3) that, when the act first became a law of the State, railroad mortgages were unknown, the reasonable inference being that "it was never intended to have any application to a species of property which then had no existence, but which had grown up since its passage, but was intended to apply to chattels that were owned, possessed, and used as they were at that time in use among the people in their pursuits of life." (Walker, J., dissented, partly on account of the earlier rulings, and partly because the constitution had declared rolling-stock, etc., to be personal property.)

[4] Hammock *v.* Farmers' Loan & Trust Co. (1881), 105 U. S. 77.

[5] This provision has been declared by a federal court not to change the rule that a mortgage covering all after-acquired property includes rolling-stock, if the lien of the mortgage attaches before that of a contesting judgment creditor. Scott *v.* Clinton & Springfield R. Co. (1876), 6 Biss. 529; s. c. 21 Fed. Cas. 820, Case No. 125,271.

[6] Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467. See further on the principle here made to depend on the character of rolling-stock as personalty, Art. II., *post*.

§ 321. **Doctrine in New Hampshire.** — In this State also rolling-stock appears to be regarded as personalty.[1]

§ 322. **Doctrine in Ohio.** — The question does not seem to have been passed upon definitely in this State, but the doctrine that rolling-stock is personalty seems to be involved in one case.[2]

§ 323. **Under the Laws of Washington and California** a mortgage of rolling-stock, whether united to a mortgage of the realty or not, is void as to creditors unless executed and recorded in the manner prescribed for chattel mortgages.[3]

§ 324. **The Doctrine of the Federal Courts** is a matter of some uncertainty. The dissenting justices in Minnesota Co. *v.* St. Paul Co.[4] said, amongst other things: "We agree that the rolling-stock upon this road covered by the several mortgages, and as respects any other valid liens upon the same, is inseparably connected with the road; in other words, is, in technical language, a fixture to the road, so far as in its nature and use it can be called a fixture."

But the doctrine of fixtures was not invoked by the majority of the court, and was in no way involved in the case, the question being whether the rolling-stock was appurtenant to the entire road or to the several divisions.

In one case in a Circuit Court,[5] Mr. Justice Miller, while declining to express an opinion as to whether rolling-stock was technically a fixture or not, ruled that it was so far a part of the road that a mortgage purporting to cover it in specific words was effectual without being recorded as a chattel mortgage; and in another it was held that rolling-stock was not a fixture in the rigid common-law sense of the word so as to become a part of the realty independently of the agreements of the parties, and that a mortgage, although in terms covering after-acquired property, did not attach to the rolling-stock of a third person subsequently placed on the road under a contract with the company.[6]

§ 325. **The Legal Character of Rolling-stock has been also considered in other Connections,** with results exhibiting the same contrariety as the cases referred to in the foregoing sections. It has been held in Iowa to be personalty for the purposes of the mechanics' lien laws, and therefore not subject to such liens.[7]

[1] Boston, Concord, & Montreal Railroad *v.* Gilmore (1858), 37 N. H. 410.

[2] Coe *v.* Columbus, Piqua, & Indianapolis R. Co. (1859), 10 Ohio St. 372.

[3] Radebaugh *v.* Tacoma & Puyallup R. Co. (1894), 8 Wash. 570; s. c. 36 Pac. Rep. 460; United Loan & Trust Co. *v.* Southern Cal. Motor Road Co. (1892), 51 Fed. Rep. 840.

[4] 2 Wall. 644; also 6 Wall. 742 (1867).

[5] Farmers' Loan & Trust Co. *v.* St Jo. & Denver City R. Co. (1875), 3 Dill. 412.

[6] Hardesty *v.* Pyle (1883), 15 Fed. Rep. 778.

[7] Neilson *v.* Iowa Eastern R. Co. (1879), 51 Iowa, 184.

In several cases it has been treated as personalty for taxation purposes.[1]

This view has prevailed even in Wisconsin, where rolling-stock has been declared to be realty for other purposes.[2]

Yet in Kentucky it is held to be taxable as a fixture.[3]

§ 326. **Opposing Doctrines discussed.** — The courts which hold rolling-stock to be personalty have laid far too much stress upon the fact that it is capable of being, and constantly is, transferred from the road-bed of the company to which it belongs to the road-beds of other companies. The instance of the pigeons flying from and returning to the dove-cote furnishes at least one illustration which goes to show that this circumstance is not a conclusive test. But this is, at best, a rather distant analogy, and it is more satisfactory to recur to general principles in determining the quality of a kind of property so essentially novel, relatively speaking, as the rolling-stock of a railroad. The really important fact to remember is that the track and the rolling-stock form, in combination, one great piece of machinery which performs the work of transportation, and thus enables the owners to carry on their business as carriers.[4]

Such machinery is not complete if either the track or the vehicles running upon it are missing. Under these circumstances it would seem a necessary inference that the character of realty which is indisputably possessed by the rails should be imparted to the rest of the machine of which they form an integral part. Under the general law of mortgages it is not thoroughly settled to what extent the machinery in a factory or mill will pass by the real-estate mortgage, but it would be difficult, we think, to find a case in which the court, having decided that a portion of a machine was a fixture, has, nevertheless, ruled that other portions necessary for its proper operation are not fixtures. If such a mortgage on a rolling-mill, for instance, will cover the entire set of rolls used in the mill, even

[1] Randall *v.* Elwell (1873), 52 N. Y. 521; Sangamon & Morgan R. Co. *v.* County of Morgan (1852), 14 Ill. 163; Pacific R. Co. *v.* Cass Co. (1873), 53 Mo. 17; s. c. 12 Am. Ry. Rep. 336; City of Dubuque *v.* Illinois Central R. Co. (1874), 39 Iowa, 56; s. c. 8 Am. Ry. Rep. 496.

[2] Chicago & North Western R. Co. *v.* Borough of Fort Howard (1866), 21 Wis. 44.

[3] Elizabethtown & Paducah R. Co. *v.* Trustees of Elizabethtown (1876), 12 Bush (Ky.), 233.

[4] This point is strongly enforced in the lucid and erudite opinion of the chancellor in Williamson *v.* New Jersey Southern Ry. Co. (1878), 28 N. J. Eq. 277; and the rule that rolling-stock is a fixture, which prevails in Canada upon the authority of the expounders of the French Civil Code and of the civil law, is based upon essentially similar reasoning. See the opinion of Taschereau, J., in Wallbridge *v.* Farwell (1890), 18 Can. S. C. 1.

those temporarily detached,[1] it is hard to see why the cars and locomotives of a railroad should not be subject to a like rule. The principle involved does not seem to be at all different. A still closer analogy may be found in passenger and freight elevators. We are not aware that it has ever been directly ruled that these are fixtures; but it would scarcely be seriously contended that they are not. How do these vehicles differ in any essential point from the rolling-stock of railroads? They both move in particular lines, established in the one case by the ways, in the other by the rails. That the movement of the one is vertical and produced by a cable worked from a stationary engine, and the movement of the other horizontal and produced by an engine travelling with its train, are surely quite immaterial details. And if on such grounds as these we should conclude that rolling-stock is realty, the mere fact that it is often removed from the land which was acquired for the purpose of operating the machine, of which it is the most indispensable portion, seems to be an insufficient reason for rejecting that conclusion. Whatever be its true quality, that can hardly be dependent on mere locality. A mortgage lien on a building is not lost if the mortgagor moves it from the land without the consent of the mortgagee, and it is impossible to argue that this result is changed by the fact that such consent is given on the understanding that the building is to be restored to its position, when the purpose for which it was removed has been fulfilled. The true principle, it is submitted, is to determine the character of the property by considering its relation to the realty on which it is ordinarily placed, and to treat the fact of its occasional or even frequent removal from that realty as a mere incident.

ARTICLE II. — CAR TRUSTS AND OTHER CONDITIONAL CONTRACTS FOR THE SUPPLY OF ROLLING-STOCK.

§ 327. **Introductory.**—In an earlier chapter (X.) the cases were reviewed which deal with the general principle that the lien of the "after-acquired property" clause is, as against one who sells property to the railroad company, postponed to any rights which the vendor may have reserved in such property when it passed out of his possession. The special application of this rule to transactions which contemplate the use and ultimately the transfer of rolling-stock is of sufficient importance to warrant a more

[1] *Ex parte* Astbury, L. R. 4 Ch. App. 630; Voorhis *v.* Freeman (1841), 2 Watts & Serg. (Pa.) 116.

particular discussion. Manufacturers or others who desire to enter into a contract of this kind may, apart from statute, secure a priority not only against the mortgage lienors, but also against subsequent creditors of the railroad company, by several different forms of agreements; but, in the ultimate analysis, these reduce themselves to three, — viz., a lease (or, more correctly speaking, a bailment for hire), a conditional sale, or a reservation of a lien in the nature of a mortgage.[1] But where the rights of creditors are concerned, the validity of the agreement will depend largely upon the character of the chattel mortgage act which may under the circumstances be applicable. (See below.)

The interposition of a trustee and the creation of a trust are by no means essential features of these transactions. It is simply a device resorted to as a matter of convenience, in order to enable a larger number of investors to become interested in a single contract. The term "car trust" is, however, derived from this practice, and has become in popular, if not in legal, phraseology a generic title for any contract of this class, whether it is accompanied by a trust or not. It is clear that a form of association adopted by the parties cannot either limit or enlarge the rights of the railroad company or others interested in the validity of the contract. For the elucidation of the subject under discussion, therefore, cases involving leases and sales of rolling-stock are equally pertinent, whether the contract is made by a car-trust association, by an individual, or by a corporation.[2]

§ 328. **A Car Trust may be defined** as an agreement of several owners of cars to place them in the hands of an agent to sell on the instalment plan, the agent having the power to issue certificates representing an interest in the instalments. A typical example of such an agreement was under review in Ricker *v.* American Loan & Trust Co.,[3] the subject of discussion being the amenability of the car-trust association to a certain taxation statute. The essential features of the contract were thus described by the court: "A number of persons formed an association, by an instrument in writing containing numerous articles,

[1] Except in Pennsylvania, where conditional sales are not valid against creditors, and the expedient of a bailment for hire, with an option of purchase after a certain time, is resorted to.

[2] An interesting article by Mr. Brodhead, dealing in popular language with car-trust certificates, will be found in the "North American Review" for March, 1891. Mr. Rawle has also very ably discussed the subject in its financial and legal aspects in an address to the American Bar Association. See Vol. 8 of the publications of that association, p. 277. The same pamphlet may also be referred to for information as to the provisions usually found in rolling-stock contracts.

[3] 140 Mass. 346; s. c. 5 N. E. Rep. 284 (1885).

for the purpose of buying, selling, and leasing railroad rolling-stock, to be sold or leased to the New York and New England Railroad Company, with provisions for admitting other persons to membership. The members of the car trust were to furnish money for the purchase of the rolling-stock, and were to have certificates for the amounts so furnished, providing that the principal sum contributed by each member should be repaid in ten annual instalments, with interest; both principal and interest being payable only out of the rentals received for the rolling-stock. Instead of the lease being made to the railroad company directly by the car trust, a plan was adopted by which the car trust delivered the property to the American Loan and Trust Company, as trustee, which trustee issued the certificates to the members of the car trust, and also executed the leases to the railroad company with provisions for a rental sufficient to meet the above payments, which in the course of ten years would pay in full for the rolling-stock, so that the rolling-stock would become the property of the railroad company at the end of that time. All contracts relating to any business of the car trust, involving liabilities for the payment of money, were to be in writing, and made under the direction of the board of managers. The original board of managers was named in the articles of association, but the shareholders were to have the power to remove them and to elect others. At all meetings every shareholder was to have one vote for each share of the stock owned by him, and provision was made for the transfer of shares, and the association was not to be dissolved by the death of members. Every owner of one or more shares was to be entitled to a proportionate share of the rentals received." [1]

§ 329. **Vendor of Rolling-stock in the Ordinary Course of Business ranks only as a General Creditor.** — The rights of one who, in pursuance of a contract of sale embracing no special provisions for his protection, delivers possession of rolling-stock to the company, without receiving payment therefor, can assert no lien upon it, either in law or equity. In relation to the company he stands on the same footing as other unsecured creditors.[2]

[1] Ricker *v.* American Loan & Trust Co. (1885), 140 Mass. 346, 347; s. c. 5 N. E. Rep. 284.

Example of car trust: McGourkey *v.* Toledo & O. C. R. Co. (1892), 146 U. S. 536; s. c. 13 Sup. Ct. Rep. 170. Another car-trust agreement is set out at length in the report of Humphreys *v.* New York, Lake Erie, & Western R. Co. (1890), 121 N. Y. 435; s. c. 24 N. E. Rep. 695; 43 Am. & Eng. R. R. Cas. 700. On the Private Ownership of Railway Rolling Stock in England, see the brief treatise by Taynton.

[2] Coe *v.* Pennock (1857), 2 Redf. Am. Ry. Cas. 669; s. c. 5 Fed. Cas. 1172, Case No. 2942; 6 Am. L. Reg. 27.

§ 330. **Mortgage Lien generally postponed to Rights reserved by Vendor until the Purchase Price is paid.** — It is well settled that the title of a vendor of rolling-stock sold under a contract which provides that, although delivered to the company, it is to remain his property until the price is paid, will prevail against the lien created by the after-acquired property clause of a prior mortgage.[1] But to take a conditional sale out of Registration Acts, it must be conditional both as to the payment of the purchase-money as well as the passing of the title. An agreement by the terms of which the purchaser becomes liable unconditionally for the purchase price, although he may never acquire the ownership of the property, is an evasion of such acts, as its purpose is simply to retain a secret lien.[2]

The rights of the vendor are the same as under a conditional sale, where, instead of reserving the ownership of the rolling-stock, he fixes a lien upon it for the payment of the price. Cars being "loose property susceptible of separate ownership and separate liens," any liens which are binding upon a railroad company itself are unaffected by a prior general mortgage given by the company, and are paramount thereto.[3]

A like preference for like reasons will be given to a lien declared by statute in favor of creditors supplying rolling-stock to railroad companies.[4]

The paramount rights of the vendor may be recognized either

[1] Fosdick *v.* Schall (1878), 99 U. S. 235; s. c. 7 Rep. 449.

In this case the court said that such an agreement was undoubtedly one which, under the Chattel Mortgage Act of Illinois, could not be valid against "third persons" unless recorded, but declared that mortgagees could not properly be described as such. "They are," said Chief Justice Waite, "in no sense purchasers of the cars. The mortgage attaches to the cars, if it attaches at all, because they are after-acquired property of the company; but as to that class of property it is well settled that the lien attaches subject to all the conditions with which it is incumbered when it comes into the hands of the mortgagor. The mortgagees take just such an interest in the property as the mortgagor acquired — no more, no less." The validity of *bona fide* contracts of this description was stated, in the recent case of McGourkey *v.* Toledo & Ohio Central R. Co. (1892), 146 U. S. 536; s. c. 13 Sup. Ct. Rep. 170, to have been universally recognized by the courts.

The same doctrine doubtless applies to all agreements which are within the terms of chattel mortgage acts, whatever their precise provisions, those acts being intended for the protection of subsequent creditors and purchasers. See Frank *v.* Denver & Rio Grande Ry. Co. (1885), 23 Fed. Rep. 123.

[2] Hart *v.* Barney & Smith Mfg. Co. (1881), 7 Fed. Rep. 543, construing the Kentucky statute.

[3] United States *v.* New Orleans Railroad (1870), 12 Wall. 362; Meyer *v.* Johnston (1879), 64 Ala. 603; s. c. 4 Am. & Eng. R. R. Cas. 584.

[4] Newgass *v.* Atlantic & D. R. Co. (Central Car Trust Co., Intervener) (1893), 56 Fed. Rep. 676, construing the Virginia Code, § 2462.

by a return of the rolling-stock *in specie*,[1] or by the payment of the price out of the proceeds of the sale.[2]

§ 331. **Rights of Persons lending Money to the Company for the Purchase of Rolling-stock.** — The protection to vendors is also extended to persons who furnish the money with which a railroad company purchases rolling-stock. If they reserve a lien on the property as security for repayment, they may stand in the place of the seller, and have the advantage of all remedies to which he would be entitled in the same situation.[3]

Directors of the corporation are entitled to the benefit of this rule where there is a distinct understanding between them and their colleagues that they are to be subrogated to the rights of the vendors to secure reimbursement for their advances, though, aside from such an understanding, their rights would be measured by the rule under which a payment by a director to secure the property of the corporation does not of itself entitle him to conventional subrogation.[4]

§ 332. **Title of Lessor of Rolling-stock paramount to that of Mortgagees.** — The title of one who makes a *bona fide* contract for the lease of rolling-stock to the company is not divested by the delivery of the property to the lessee; but rolling-stock, when once placed upon the road under circumstances which create no lien in favor of a car-trust association, cannot be brought within the operation of a lease subsequently executed, which purports to embrace the stock thus delivered.[5]

As against a prior mortgage of the company containing an after-acquired property clause the title of a manufacturer of cars will hold good under an unrecorded contract by which the company agrees to pay certain monthly sums for the "hire" of the cars, and is to have the option of buying them at a fixed price; while the "lessor" is to have the right, in case of a default in the monthly payments, to rescind the contract and retake the cars.[6]

[1] Fosdick *v.* Schall (1878), 99 U. S. 235; s. c. 7 Rep. 449.

[2] Fosdick *v.* Car Co. (1878), 99 U. S. 256.

[3] Frank *v.* Denver & Rio Grande R. Co. (1885), 23 Fed. Rep. 123.

[4] Coe *v.* New Jersey Midland R. Co. (1879), 31 N. J. Eq. 105.

[5] McGourkey *v.* Toledo & Ohio Central R. Co. (1892), 146 U. S. 536; s. c. 13 Sup. Ct. Rep. 170; affirmed Central Trust Co. *v.* Ohio Central R. Co. (1888), 36 Fed. Rep. 520. The principle is, however, brought out more clearly in the opinion of the lower court. See pp. 530, 531, of the report.

[6] Meyer *v.* Car Co. (1880), 102 U. S. 1. The court considered it unnecessary to decide "whether a lease of personal property at a specified rent, with an option in the lessee to buy for a fixed price, is in effect a conditional sale." That question would doubtless have been of paramount importance if the adverse interest had been that of a creditor. See below.

§ 333. **Car-trust Certificates in Effect Mortgage Bonds of the Company itself.** — These are inferior in point of lien to an earlier mortgage on the railroad containing the after-acquired property clause. This construction has been placed upon a contract of lease which provided that the yearly instalments to be paid for the use of rolling-stock which was to be subsequently manufactured and delivered to the company, and to become its property when all the instalments during the stipulated period had been paid, should be evidenced by obligations of the company maturing at different times, with interest coupons attached. The rolling-stock not being in existence at the time the contract was made, the transaction could not, it was held, be regarded as a conditional sale; while the provisions that, if the annual payments were made promptly for the period specified, the property should belong to the railroad company without further conveyance, and that in case of default the lessor might resume possession for the purpose of sale, showed that it was not an ordinary bailment contemplating merely the use of the equipment by the company. The so-called "lease" and the car-trust agreements entered into for the purpose of carrying it out really amounted to a contract for the loan of money to the company, for which it was to execute its bonds, to be secured by a mortgage on its rolling-stock, to be selected and designated at a future day after it had come into the possession of the company.[1]

In an earlier case in another court a very similar ruling had been made as to the status of persons supplying equipment under a contract of this description, it being held by Judge Hallett that, in so far as they have any position in the law, lessors of rolling-

[1] Central Trust Co. *v.* Ohio Central R. Co. (1888), 36 Fed. Rep. 520. This view as to the true character of the so-called leases was approved by the Supreme Court (McGourkey *v.* Toledo & Ohio Central R. Co. (1892), 146 U. S. 536; s. c. 13 Sup. Ct. Rep. 170), which, however, relied mainly on the principle that, as the car-trust certificates were evidences of a contract made by the directors in breach of their fiduciary obligations, the transaction was a constructive fraud upon, and therefore voidable by, the bondholders or those claiming under them. (See next section.)

Whether the case can be sustained solely on the grounds assigned in the lower court seems very questionable. The objection insisted upon by Judge Jackson, that if such agreements are to be given effect to, the after-acquired property clauses would become idle and useless provisions, is scarcely conclusive, when it is conceded that certain kinds of contracts which produce that result are enforceable. Unless, therefore, such contracts are subject to exception, for some reason apart from the fact that they deprive bondholders of their lien over the subject-matter, it is difficult to see why they should not be equally valid, in whatever form they are couched. That this was the view of the Supreme Court may perhaps be inferred from the stress laid upon the constructively fraudulent character of the transportation. (See the case next cited.)

stock are to be regarded as mortgagees, where neither they nor any one represented by them have at any time owned the stock, and the so-called "lease" is merely a contract for the loan of money, to be repaid by periodical instalments styled "rent." But it was at the same time declared that the assumption of a false character by the payees would not affect their rights if the equities of the transaction were with them.[1]

§ 334. **Car-trust Agreements in Breach of Fiduciary Obligations of Directors not upheld as against Bondholders.** — The lien of the holders of car-trust certificates will not prevail against the lien of an earlier mortgage covering after-acquired rolling-stock, where the transaction violates the well-settled rule which renders any arrangements by which the directors of a corporation become interested adversely to such corporation in contracts with it voidable at the option of parties prejudiced by such contracts. If, therefore, the directors make with themselves, or those holding confidential relations to them, a contract for the supply of rolling-stock to the company, which, though in form a lease, is in effect a purchase by the company, with a lien reserved in favor of the holders of the car-trust certificates, most, if not all, of such certificates being held by the directors, the transaction will be construed as a constructive fraud on the mortgagees. The device of the car-trust certificates will in such a case be inoperative either to vest the legal title in the trustee named therein, or to prevent the mortgage attaching as a prior lien to such rolling-stock as is delivered under the contract. The position of the holders of the car-trust certificates is not strengthened in such a case by the fact that the lease provides that the company may contract for the delivery of the stock directly with the maker, and that the stock shall be marked in such a manner as to show that it belonged to the car-trust association. The essential vice of such a transaction does not lie in any attempted concealment of the actual facts, but inheres in the very nature of the contract. The purpose being unlawful, an open avowal of that purpose does not make it less unlawful.[2]

§ 335. **How far Rolling-stock Contracts are effectual against Subsequent Creditors of the Company.** — At common law a contract by which the owner of personalty gives to another party the possession and use thereof in consideration of the latter's paying certain

[1] Frank *v.* Denver & Rio Grande R. Co. (1885), 23 Fed. Rep. 123.

[2] McGourkey *v.* Toledo & Ohio Central R. Co. (1892), 146 U. S. 536; s. c. 13 Sup. Ct. Rep. 170, Fuller, C. J., and Brewer, J., ably dissenting. For a statement of the ruling in the lower court, see above.

sums of money at stated times, with the understanding that the title to the property will not pass till the last of those sums is paid, will be upheld against the creditors of the owner of the personalty, whether he be called bailor, lessor, or vendor.[1]

But the practical working of this principle has been greatly modified by the various chattel mortgage acts, the effect of which may in many cases be that a contract of sale which is a perfect protection to the vendors, so far as the mortgagees are concerned, may some time be treated as invalid where the rights of creditors are in question.[2]

Where the policy of the law is, as in Illinois, against the maintenance of secret liens which treat the vendor of personal property, who has sold and delivered possession of it to the purchaser, as the owner until the payment of the purchase-money, a vendor of rolling-stock, if he wishes to retain a security for the price which will prevail against the creditors of the company, must comply with the provisions of the Chattel Mortgage Act.[3]

On the other hand, it is held that the title of a vendor of rolling-stock will prevail against that of one who purchases it at an execution sale of the company's property, where the registry law, like that of Missouri, embraces only mortgages and deeds of trust of personal property.[4]

§ 336. **Name given by the Parties to the Contract not conclusive as to its Real Nature.** — In view of the limitations upon the freedom of contract under chattel mortgage acts, the point upon which a case in which the rights of creditors are concerned must often turn is the question whether the contract of sale is within its provisions. It is well settled that "the answer to this question is not to be found in any name which the parties may have

[1] See the cases cited in Bennett's edition of Benjamin on Sales, Bk. 2, Chap. III.

[2] See, for example, the facts of Fosdick *v.* Schall, referred to *ante*.

[3] Hervey *v.* Rhode Island Locomotive Works (1876), 93 U. S. 664.

The court said: "The policy of the law in Illinois will not permit the owner of personal property to sell it, either absolutely or conditionally, and still continue in possession of it. Possession is one of the strongest evidences of title to this class of property, and cannot be rightfully separated from the title, except in the manner pointed out by the statute."

[4] Rogers Locomotive Works *v.* Lewis (1877), 4 Dill. 158. Judge Dillon, however, in view of the decision in the case last cited, expressed a wish that the case would be taken to the Supreme Court. The correctness of his ruling does not seem to have been directly passed upon by that court, but its reasoning in Heryford *v.* Davis (see below) shows very plainly that it did not regard a *bona fide* conditional sale as being within the purview of the Missouri statute. That statute provides that no chattel mortgage "shall be valid against any other person than the parties thereto, unless possession of the mortgaged property shall be delivered to and retained by the mortgagee, or unless the mortgage shall be recorded" in a prescribed manner.

given to the instrument, and not alone in any particular provision it contains, disconnected from all others, but in the ruling intention of the parties, gathered from all the language they have used.[1]

The operation of a statute applicable to sales in which the vendor reserves a lien upon the subject-matter until the purchase price is fully paid cannot be evaded by giving the transaction the form of a lease. Wherever such a statute exists, its provisions must be complied with in order to validate what are essentially conditional sales; otherwise they are liable to be defeated by creditors of the purchaser who is in possession of it. A provision that the title is to pass to the purchaser when the last of a certain number of periodical payments is discharged, is regarded as almost conclusive evidence that the transaction is a sale and not a lease, even though the sums stipulated to be paid are termed rent.[2]

Similarly a contract in the form of a lease will be avoided as against the creditors of the so-called lessee, where it is in effect a mortgage, and not recorded as such in conformity with the statute. Since genuine contracts of lease or bailment for hire must include, as one of their essential features, a stipulation to pay for the use of the thing hired, an instrument which not only does not provide for any such payment, but strongly negatives the intention to demand it, cannot be classed among such contracts. Thus where the manufacturing company takes promissory notes for the entire selling price of the property, and in addition thereto collaterals to a large amount, and those notes are all to mature within a few months, the result being that the vendors will, at the end of that time, have in hand the full price of the cars, the contract cannot be construed as a mere letting or bailment for hire.[3]

[1] Heryford *v.* Davis (1880), 102 U. S. 235, per Strong, J.; S. P. Hervey *v.* Rhode Island Locomotive Works (1876), 93 U. S. 664; Fidelity Insurance, Trust, & Safe Deposit Co. *v.* Shenandoah Valley R. Co. (1889), 32 West Va. 244; s. c. 38 Am. & Eng. R. R. Cas. 559; 9 S. E. Rep. 185; Central Trust Co. *v.* Ohio Central R. Co. (1888), 36 Fed. Rep. 520. Compare the cases cited above in this chapter.

[2] Hervey *v.* Rhode Island Locomotive Works (1876), 93 U. S. 664, citing Murch *v.* Wright, 46 Ill. 487.

[3] Heryford *v.* Davis (1880), 102 U. S. 235. Mr. Justice Bradley, dissenting, held that the contract was a valid conditional sale. This decision is certainly *strictissimi juris*, as it virtually amounts to a ruling that, even under a chattel mortgage act drawn in terms apparently very favorable to the validity of conditional sales, the vendor cannot so arrange the payment of the instalments of the price or the rent as to make the passing of the title conditional on the payment of the last one, without running a serious risk, to say the least, of finding himself postponed to creditors. The practical inference which may perhaps be drawn from this and other deci-

In the case just cited it was further sought to sustain the priority of the vendors' rights on the ground that the transaction was one contemplating a reservation of the ownership until the price was fully paid. The contract stated that the cars were "to remain the property of the vendors, to be accounted for and to be redelivered to them when demanded, in default of the payment" of the aggregate sum evidenced by the promissory notes given by the railroad company. But the court said this stipulation, when construed in connection with the other provisions, was plainly inserted to enable the manufacturers to enforce payment, not of any rent or hire, but of the selling price for which they took the notes. It was, in short, intended as additional security for the payment of the company's debt.

The result of the decision cited in this and the preceding section would seem to be briefly this: The true nature of the contract must first be ascertained by a consideration of all its provisions. If it is construed to be a sale, and the title as well as the possession is found to have vested in the vendee, and the only interest preserved in the property by the vendor is a lien, the transaction will probably be void as against creditors under every chattel mortgage act. If the title remains in the vendor, and the vendee has only the possession and use of the property until the price is fully paid, the question whether the vendor's rights will prevail against those of the creditors of the vendee depends upon whether the chattel mortgage act which is applicable belongs to the same class as that of Illinois or that of Missouri. In the latter case the contract will protect him, in the former it will not.

§ 337. **Rights of Certificate Holders who refuse to assent to a Modification of a Car-trust Lease.** — These rights are those secured to them by the original instrument, when the trustees in the second contract expressly state that they are acting on behalf of assenting certificate holders only. Under such circumstances the actual extent of the trustees' power to bind dissentients is immaterial. The trustees, therefore, are not assuming an inconsistent

sions is that the safest plan in every case is to bring the transaction under the provision of a chattel mortgage act, unless the legislature happens to enact some statute which contemplates the recording of conditional sales of rolling-stock. The only alternative plan which offers anything like equal security is to draw the contract so that the lessees or vendee may have an option to purchase, at the end of a specified period, for a substantial and not merely nominal sum of money over and above what he may already have paid by way of compensation for the use of the cars. On rights after default, see O'Hara *v.* Mobile & O. R. Co. (1895), 75 Fed. Rep. 130.

position when they undertake to sue the company for the rent stipulated in the first lease, provided they act as representatives of those certificate-holders only who have withheld their assent to the second contract. This result cannot be affected by the fact that the railroad company and the assenting holders supposed the action of the trustees to be binding on the non-assenting holders, as that would merely be an error as to the legal effect of a written instrument.[1]

§ 338. **Rights of the Holders of Rolling-stock Securities when the Road has passed into the Hands of a Receiver.** — Where the payments due under a car-trust lease have been in default for some time previous to the appointment of a receiver, and the lessor, when such appointment is made, demands immediate possession of the cars, the failure of the receiver to comply with that demand, and his continuing the use of the cars for some months afterwards, do not amount to a conversion of the property entitling the lessor to have a lien declared upon the *corpus* of the estate for the amount due to him. The receiver in such a case does his full duty in relation to the car-trust property by reporting the facts to the court and asking its direction, and he cannot surrender it without the authority of the court. Nor can the lessor assert that by permitting the insolvent railroad company to remain in possession of the road after default had occurred the bondholders in effect pledged the mortgaged property as security for the rental in advance of the mortgages. All that the lessor is entitled to is that the cars shall be surrendered in a reasonable time, and that he shall be paid a fair rental as on a *quantum meruit* for the use by the receiver.[2]

Where the lessor and mortgagor companies are dominated by the same persons, the court will disregard the terms of the lease and award the lessor company such reasonable rent as it could obtain in the open market for similar cars to be used in the same manner.[3]

The periodical payments maturing within a reasonable time prior to a receivership under a contract of sale of rolling-stock, whereby the title is reserved to the vendor until all the payments are made, may properly be included among the debts which a

[1] Humphreys *v.* New York, Lake Erie, & Western R. Co. (1890), 121 N. Y. 435; s. c. 24 N. E. Rep. 695; 43 Am. & Eng. R. R. Cas. 700.

[2] Farmers' Loan & Trust Co. *v.* Chicago & Atlantic R. Co. (1889), 42 Fed. Rep. 6; s. c. 8 Ry. & Corp. L. J. 184.

[3] Thomas *v.* Peoria & R. I. Ry. Co. (Western Car Co., Intervener), (1888), 36 Fed. Rep. 808; 36 Am. & Eng. R. R. Cas. 381.

receiver will be directed by the order appointing him to discharge out of the income of the road.[1]

But such payments are not entitled to priority, as against the mortgage debt, in the distribution of the proceeds of the sale.[2]

For the purposes of this rule, it is immaterial whether the periodical payments are styled rentals or instalments of the price.[3]

If, however, the receiver takes possession of and uses rolling-stock sold on these terms, the sum which he thereby becomes liable to pay is a charge upon the *corpus* of the estate prior to the mortgage lien.[4]

After the vendor of rolling-stock, who reserves the ownership thereof until the purchase price is paid, has exhausted his special remedy by reclaiming the property from the receiver, he stands, as regards the proceeds of the foreclosure sale, merely in the posi-

[1] Fosdick *v.* Schall (1878), 99 U. S. 235 ; s. c. 7 Rep. 449 ; Sage *v.* Central R. Co. (1878), 99 U. S. 334 ; Frank *v.* Denver & Rio Grande R. Co. (1885), 23 Fed. Rep. 123.

[2] Kneeland *v.* American Loan & Trust Co., 136 U. S. 89 ; s. c. 10 Sup. Ct. Rep. 950 ; 43 Am. & Eng. R. R. Cas. 519 ; Central Trust Co. *v.* Toledo, D. & B. R. Co. (Circuit Ct., Dist. of Ind.), an unreported case, in which, as stated in High on Receivers (2d ed.), 340, note 2, it was ordered by Gresham, J., Woods, J., concurring, that rentals of rolling-stock held by the company under car-trust leases should, for the period of use by the receiver, be paid as a first lien out of receiver's income, or out of the proceeds of foreclosure sale before distribution to mortgage bondholders, and that rentals for six months prior to the receivership should be paid out of the net income of the receiver. See also Mather Humane Stock Trans. Co. *v.* Anderson (1896), 76 Fed. Rep. 164 ; Eastern & Midlands Railway, 65 Law Times, 669.

[3] Kneeland *v.* American Loan & Trust Co. (1890), 136 U. S. 89 ; s. c. 10 Sup. Ct. Rep. 950 ; 43 Am. & Eng. R. R. Cas. 519.

[4] Fosdick *v.* Car Co. (1878), 99 U. S. 256 ; Myer *v.* Car Co. (1880), 102 U. S. 1 ; Kneeland *v.* American Loan & Trust Co. (1890), 136 U. S. 89 ; s. c. 10 Sup. Ct. Rep. 950 ; 43 Am. & Eng. R. R. Cas. 519 ; Central Trust Co. *v.* Toledo, D. & B. R. Co. (Circuit Ct., Dist. of Ind.), an unreported case.

In Turner *v.* Indianapolis, Bloomington, & Western R. Co. (1879), 8 Biss. 527, the court allowed the vendor of certain locomotives to a railroad company to bring an action against the receiver for rental and for damages to them while being used by him, and held that the amount found to be due was payable out of the funds in the receiver's hands. But the report does not show whether those "funds" were earnings or the proceeds of the sale.

The "working expenses" which a receiver appointed at the instance of a judgment creditor under the English act of 1867 is required to pay, include, as against the debenture-holders, the instalments due on an agreement for the hire of rolling-stock, which is to become the property of the company upon the payment of all the instalments of rent. *In re* Eastern & Midlands Railway Co. (1890), L. R. 45 Ch. Div. 367. See also, in same matter, 65 L. T. Rep. 668; 66 L. T. Rep. N. S. 153 ; 8 Ry. & Corp. L. J. 384 ; *Re* Cornwall Minerals Ry. Co., 48 L. T. N. S. 41. The former case holds that the expression "working expenses" covers instalments in arrear as well as the current ones. For a transaction which was held not to be a borrowing of money, but a *bona fide* sale and hiring of rolling-stock, and valid, see Yorkshire Ry. Wagon Co. *v.* Maclure (1882), 21 Ch. Div. 309.

tion of a general creditor, and therefore cannot claim any special preference in the distribution of the fund, unless it can be shown that the current income of the receivership or of the company has been employed in a manner which has deprived him of his equitable rights.[1]

§ 339. **Can the Court authorize a Receiver to create a Car Trust.** — The essentially temporary nature of the control exercised by the court over the corporate property during a receivership renders it very doubtful whether the equipment of a road through a car-trust agreement which it will require a considerable period to carry out is within the proper scope of a chancellor's authority. But such an agreement should, at all events, not be authorized where the ground on which the receiver supports his application is that the earnings will, as a result of the car trust, be set free for the payment of the bonded interest. It is better to allow the interest to go unpaid rather than to pay it by means of borrowed money, and so mislead creditors and others respecting the actual condition of the road.[2]

[1] Fosdick *v.* Schall (1878), 99 U. S. 235; s. c. 7 Rep. 449; Huidekoper *v.* Hinckley Locomotive Works (1878), 99 U. S. 258.

In the latter case locomotives, after being used for some time, were returned in an injured condition, and then sold to other companies, leaving a certain sum due to the vendors. The Supreme Court held that the sum thus found due was not in reality for the use and repair of the engines, but on account of what was agreed to be paid for the purchase, and reversed the decree of the Circuit Court which allowed it to be paid out of the proceeds of the sale in the receiver's hands.

[2] Taylor *v.* Philadelphia & Reading R. Co. (1881), 9 Fed. Rep. 1; s. c. 3 Am. & Eng. R. R. Cas. 177.

CHAPTER XV.

PREVENTIVE REMEDIES, OR REMEDIES OF BONDHOLDERS FOR INTERFERENCE WITH THE MORTGAGED PROPERTY.

§ 340. **Injunctions against Acts of the Mortgagor impairing the Security.** — It is familiar learning that equity will interfere at the instance of a mortgagee to prevent waste by the mortgagor in possession.[1]

Thus an injunction will be granted against the company, at the suit of a bondholder, to restrain it from taking up any part of the railroad covered by the mortgage. The company have no right to touch it except for proper repairs and lawful use; and it is no defence to a suit for such injunction that the security of the plaintiff will not be materially impaired by the proposed action of the defendants, or that the portion of the road they are taking up is not self-sustaining, but an expense to other roads belonging to

[1] High on Injunctions, § 478.

them, or that the defendants are willing to give security for the moneys received from the sale of the materials of that part of the road which is being taken up.[1]

§ 341. **Injunctions against Acts of Third Persons impairing the Security.** — Any act of a third person which will impair the security of the bondholders by diminishing the value of the mortgaged property presents an occasion for the intervention of a court of equity, provided the ordinary condition precedent to such intervention exists, viz., that the legal remedy is inadequate.

Thus a bondholder secured by a mortgage on the lands of a corporation has an interest therein equally with stockholders, and may, like the latter, maintain a suit to prevent another corporation from obtaining the same lands by the wrongful use of the name of the corporation the bonds of which he holds. But such a suit can be maintained only upon an allegation that the corporation has refused to take proper steps to protect the rights of the petitioner.[2] So also a receiver has been granted an *ex parte* injunction to restrain another company from building approaches to a tunnel over the mortgaged property, to the prejudice of the bondholders, where the right to do so was claimed under an agreement made after the execution of the mortgage. But it was held to be improper to determine the question whether the license thus granted was subordinate to the rights of the mortgagees, without making the second company a party to the proceedings. The temporary injunction was, therefore, modified so as to allow the second company to proceed with the construction of the approaches, upon condition that it should pay for all the alterations in the petitioner's track, where rendered necessary by the work to be done, and also give a bond to pay for all the other damage inflicted in case the result of the proceedings was unfavorable to it.[3]

§ 342. **Injunctions against Execution Sales of Personal Property generally.** — The settled rule is that "until the mortgage is enforced by entry or judicial claim the personal property of the railroad company is subject to its disposal in the ordinary course

[1] Watt *v.* Hestonville, Mantua, & Fairmount Passenger Ry. Co. (1867), 1 Brewst. (Pa.) 418; s. c. 6 Phil. 386. That waste by the mortgagor may also be a ground for appointing a receiver, see *post*, Chap. XXIX. For miscellaneous cases on the remedies of bondholders for protection of the property mortgaged see the following cases: 25 Nova Scotia R. 140 (1893); Watt *v.* Senecal, 4 Q. L. R. 76; 1 L. N. 98; Morrison *v.* G. T. Ry. Co., 5 L. C. J. 313; Legg *v.* Matthieson, 2 Giff. 71; Wild *v.* Mid. Hants Ry. Co., 16 W. R. 409.

[2] Newby *v.* Oregon Central R. Co. (1870), 1 Sawy. 64.

[3] Coe *v.* New Jersey Midland R. Co. (1877), 28 N. J. Eq. 27.

of business, and as such is liable to be seized and taken on execution for its debts." [1]

Under Minnesota Gen. Stat. 1878, ch. 34, §§ 72, 73, the rolling-stock and property of a railroad mortgaged under these sections is an entirety, and cannot be levied on separately, and an execution sale will be enjoined at the instance of the mortgagee.[2]

Under Texas Const., art. 10, § 4, providing that rolling-stock shall be personal property, and that all of the property of a railroad shall be subject to execution, and Texas Rev. Stat., art. 2287, providing that a levy shall be first made on personal property where it is delivered into possession of an officer, the fact that a levy on a box-car was not made before a levy upon the realty will not be ground for an injunction where possession was not delivered as required by the statute.[3]

In England, before the act of 1867 was passed, a judgment creditor could issue his *fi. fa.* and seize all the rolling-stock and all other chattels of the company. As this placed it in the power of such a creditor to strangle the whole undertaking, Parliament interfered and limited his remedy to a receivership.[4]

A dock company authorized by the act incorporating it to build a railway is entitled to the protection given by the act of 1867.[5]

§ 343. **When Equity will interfere to protect the Lien of an After-acquired Property Clause.** — In practice the effect of the rule just stated is considerably modified by the fact that railroad personalty is almost invariably subject to the lien of an after-acquired clause. That this lien must be allowed priority over a subsequent judgment follows from the nature of the contract creating it. (See Chap. X., *ante.*) That a court of equity will always interfere when the result of an execution sale will be to render an already inadequate security still more inadequate, or change an adequate security into an inadequate one, also follows from the general principle that an irreparable injury to property rights will be prevented as a matter of course by injunction. So far the authorities are quite harmonious.[6]

[1] Union Trust Co. *v.* Morrison (1888), 125 U. S. 591; s. c. 8 Sup. Ct. Rep. 1004; 33 Am. & Eng. R. R. Cas. 33.

[2] Central Trust Co. *v.* Moran (1894), 56 Minn. 188; s. c. 57 N. W. Rep. 471; 29 Law Rep. Ann. 212.

[3] Texas & Mexican Ry. Co. *v.* Wright (Tex. Sup. Ct., 1895), 31 S. W. Rep. 613.

[4] See the opinion of Kay, J., *In re* Eastern & Midland Ry. Co. (1890), L. R. 45 Ch. Div. 367; s. c. 8 Ry. & Corp. L. J. 384.

[5] Great Northern Ry. Co. *v.* Tabourden, L. R. 13 Q. B. D. 320, where an execution sale of a hydraulic lift used by the company was enjoined.

[6] Coe *v.* Columbus, Piqua, & Ind. R. Co. (1859), 10 Ohio St. 372; Coe *v.* Peacock (1863), 14 Ohio St. 190; Lane *v.*

Upon the ground of the resulting inadequacy of the security, the court will enjoin an execution sale by a creditor whose claims come under the head of "running expenses," even though the mortgage contains an express reservation of so much of the income as may be necessary to pay for those expenses. The proper remedy of such a creditor is, in equity, to charge the earnings of the company as a fund, and to subject so much thereof as may be necessary to the payment of the judgment not to remove and sell by execution disconnected portions of the road, and thus deprive the mortgagee of his security.[1]

But a somewhat embarrassing divergence of view is disclosed by the cases in regard to the further question, whether the inadequacy of security resulting from a sale on execution is the *sole* ground on which an injunction to restrain it will be granted.

In some jurisdictions it would appear that, unless some special equity is alleged, the bondholder will not be granted an injunction even for the temporary purpose of ascertaining whether the case is a proper one for interposition. In other words, a judgment creditor is allowed to act on the defensive all through the proceedings, and compel the bondholders to show affirmatively that there is some reason besides the mere existence of the lien which renders it inequitable to permit the judgment to be enforced. This is the doctrine in Ohio, where at any stage of the proceedings the one essential condition precedent to obtaining equitable relief against the enforcement of a judgment is to show that the mortgaged property will be rendered by the execution sale an inadequate security for the mortgage debt. That the constant and uninterrupted use of the property by the company is indis-

Baughman (1867), 17 Ohio St. 642; Ludlow *v.* Hurd (1857), 1 Dis. (Ohio) 552. In Union Trust Co. *v.* Morrison (1888), 125 U. S. 591; s. c. 8 Sup. Ct. Rep. 1004; 33 Am. & Eng. R. R. Cas. 33, the opinion of the court that the serious dislocation of the business of the company which must result from a seizure of rolling-stock, and its consequent separation from the *corpus* of the estate, was a sufficient reason for giving a person who prevented such a catastrophe by becoming surety on an injunction bond, in a suit filed by the company to restrain the levy, a preference over the mortgagees, in the distribution of the proceeds of a subsequent foreclosure sale of the estate, for the amount which he was ultimately obliged to pay on his bond.

In Brady *v.* State (1866), 26 Md. 290, a part of the relief asked for in a petition for an injunction against an attachment was that the sale of certain specific articles of personal property subject to a statutory mortgage should be restrained, inasmuch as they were necessary to keep the canal subject to the mortgage in proper repair. Under the circumstances disclosed in the record the court did not think it necessary to express any formal opinion, but thought that the facts showed a case in which an injunction would be proper.

[1] Lane *v.* Baughman (1867), 17 Ohio St. 642.

pensable to enable it to earn money with which to pay interest on the bonds is not a circumstance which will raise a superior equity in favor of the bondholders.[1]

A similar view has been taken by a federal judge who denied the petition of a trustee for an injunction against an execution sale of certain portions of the property of a railroad company, taking the broad ground that the sale would be made subject to any prior rights of the bondholders, and that he could not assent to the theory on which the bill was framed; viz., that none of the obligations of the corporation, even though judicially determined, are enforceable against its property, where there is a prior mortgage covering such property.[2]

In Illinois also it would appear that a court of equity, when asked to restrain an execution sale of railroad personalty, requires some special ground to be shown for an injunction besides the mere fact that it is subject to a mortgage. Where a bill was filed on the theory that rails, bridge timber, and wood were not subject to levy, it was held that no injunction should have been issued to restrain the sale of the wood. The other two species of property were protected as being fixtures.[3]

[1] Coe *v.* Knox County Bank (1859), 10 Ohio St. 412. In Coe *v.* Peacock, 14 Ohio St. 187 (1862), the trustee undertook to replevy the property after the sale. It was held that, as the mortgage gave him no right "to take from the corporation portions of the property mortgaged, except when exercising a *bona fide* attempt to possess himself of the whole work, he stood upon no higher ground in this respect than an officer who had legally levied an execution on the property, and thereby succeeded to all the interests which the corporation had, and that in no event could he be permitted to use the power, either with or without legal process, for the purpose of restoring to the corporation the possession and use of the property which had been taken from it" (by the levy). The replevy, therefore, was wrongful, but as it appeared that the lien very far exceeded the entire value of the property included in the mortgages, the defendant in the replevin suit was allowed to recover only nominal damages. Under such circumstances the levy bound no substantial interest, and the defendants lost substantially nothing in losing the possession of the property.

[2] Eells *v.* Johann (1886), 27 Fed. Rep. 327. The learned judge does not refer to any of the earlier authorities on the subject, which are cited in the present section, and the case seems to have been decided without much consideration. It is quite possible to agree fully with the propositions on which the opinion was based, and yet dissent from the conclusion drawn from them, unless it is intended merely as a ruling that on the pleadings submitted the relief asked for could not be granted. Possibly this is all that the case is really meant to decide, though the report does not state what the precise allegations of the bill were. If its contents were at all similar to those of the bill in Pennock *v.* Coe, *infra*, it is evident that the case is in conflict with the doctrine adopted by the Supreme Court. The questions raised by the learned judge, however, were quite unnecessary, as the execution had issued out of a state court, and in such a case a federal court is powerless to act. (See *post.*)

[3] Fahs *v.* Roberts (1870), 54 Ill. 192. The report is too meagre to show whether this case is not open to the same objection as the one last cited.

Other courts have shown much greater readiness in interfering for the protection of the bondholders, and we think that a reasonable inference from the authorities cited below is, that the mere fact of the property levied upon being subject to the lien of the after-acquired property clause will warrant a court of equity in issuing an injunction to stay the sale, the question whether the injunction shall be made perpetual being left to be decided by the facts disclosed. Several very weighty reasons, as will be seen, may be given for at least a temporary assumption of exclusive control of the proceedings by a court of equity.

One of the grounds upon which the Supreme Court of the United States, in the leading case of Pennock *v.* Coe,[1] upheld the issuance of an injunction restraining a judgment creditor from levying on certain rolling-stock subject to the lien of an after-acquired property clause, was that the bondholders presented the superior equity to have the property in question applied to the discharge of the bonds.

The remedy suggested, in case the property was more than sufficient to pay the demands of the bondholders, was, not to allow the execution creditor to sell the property covered by the mortgage, but to compel the prior incumbrances to satisfy the execution, or, on a refusal, the mortgage having become forfeited, compel foreclosure and satisfaction of the bond debt, so as to enable the judgment execution creditor to reach the surplus, or upon any unreasonable resistance of the claim of the execution creditor, or inequitable interposition for delay, and to hinder and defeat the execution, permit a sale of the rolling-stock sufficient to satisfy it. So in Kentucky it has been held that a party having an equitable lien on railroad property by virtue of the after-acquired clause of a mortgage may, if such property is sold on execution by a third person, apply to a court of equity for a redelivery thereof, or for an order restraining its removal, and, if the sale has not yet taken place, procure an injunction to stay it.[2]

[1] 23 How. 117 (1859). The judgment creditor in this case was a holder of bonds secured by a junior mortgage, and the injunction was asked for by the trustees of the first mortgage. But from the present point of view it is clearly quite immaterial that the execution was to satisfy a secured and not an unsecured debt.

[2] Phillips *v.* Winslow (1857), 18 B. Mon. (Ky.) 431. The court placed its decision on two grounds: (1) that the act complained of (in this case an actual sale) was not only in violation of the plaintiff's right; (2) that it was of a character that might produce irreparable injury to the plaintiff, and great inconvenience to the public. The jurisdictional powers of the court were placed upon the ground that, "as the mortgagee had only an equitable right to the property, he had a clear right to apply to a court of equity for relief."

So also it has been ruled in Pennsylvania that the rolling-stock and equipments of a railroad cannot be seized in execution after the company has become insolvent, or has mortgaged such rolling-stock and equipments, the equity which in such a case will restrain the sale, springing out of the insolvency, or the trusts created by the mortgage.[1]

So also in Iowa the rights of the trustee to restrain an attachment or execution against the earnings of a railroad was placed upon the ground that they were among the property expressly pledged.[2]

These four cases receive a negative support from a Maine case, where the court denied an injunction, on the ground that the consent of a mortgagee that a railroad may use and dispose of articles like fuel for its own benefit, and the use of such articles in pursuance of that consent, are acts tantamount to a waiver of the lien of the mortgage, and therefore constitute a sufficient reason for the refusal of a court of equity to interfere for the protection of the lienors' rights.[3]

Possibly it may be said that in Maryland also the same view prevails.[4]

It is also deserving of notice that the ground on which general creditors were allowed, prior to the English Railway Act of 1867, to levy on the property of a company was that the bondholders had no specific lien on the property of the company under the forty-fourth section of the Companies Clauses Act, providing to be paid out of the "tolls, property, and effects" of the company.[5]

Plainly, therefore, if they had been held to have such as bondholders in this country have, an execution sale would have been illegal, and would presumably have been restrained as a matter of course, as in the cases cited above.

[1] Londenslager *v.* Benton (1861), 4 Phil. 382. In this case, as there was a doubt about the power of the company to mortgage, the court, while refusing to decide that question on a motion for a special injunction, enjoined the creditors and sheriff from selling the property covered by the mortgage, but directed that the lien of the *fi. fas.* should continue till further orders. As to the special case in which the judgment creditor is one of the bondholders, see below.

[2] Dunham *v.* Isett (1863), 15 Iowa, 284. Other cases hold that such a pledge does not change the general rule that a mortgagor is entitled to the income of the mortgaged property as long as he remains in possession. But this fact does not affect the pertinency of the authority in regard to the subject under discussion. As to the rights of the lienor where the earnings are specifically appropriated to certain purposes, see *post.*

[3] City of Bath *v.* Miller (1865), 53 Me. 308.

[4] See Brady *v.* State (1866), 26 Md. 290; Brady *v.* Johnson (1892), 75 Md. 445; s. c. 26 Atl. Rep. 49, where, however, the fact that the rights of the parties were created by legislation having some peculiar features may, to some extent, have influenced the courts.

[5] Russell *v.* East Anglican Ry. Co. (1850), 3 Mac. & G. 124. See note at end of chapter.

The difference of opinion disclosed by the above summary is perhaps due, in some degree, to a difference of opinion as to the precise nature of a trust deed. The attitude of the courts which decline to interfere with an execution sale, unless it is affirmatively shown that impairment of the security will result, is intelligible if the deed merely creates a lien, for on technical grounds, at least, there is then no reason why the mere existence of this, any more than other liens, should preclude an execution sale. The maxim *caveat emptor* being applicable, the property remains burdened with the lien after as before the transfer. On the other hand, if, as seems to be most in accordance with principle, and perhaps with authority,[1] a conveyance to trustees which leaves nothing but the equity of redemption in the grantor, it is difficult to see how a sale of the property itself can be proper except through equitable proceedings. Even where statutes have made such an interest subject to levy, the sale will not deprive the corporation of the use of the property; for if the words of the trust deed are to have due force, it can only be deprived of such use by proceedings taken upon breach of one or other of the conditions of that instrument. In an early Indiana case, however, it was held that the sheriff would not be enjoined from selling the company's equity of redemption in personalty covered by an "after-acquired property" clause, but that the purchaser would not be allowed to take possession of the property until he had complied with the conditions of the mortgage.[2]

§ 344. **Inadequacy of Legal Remedy as a Ground for Interference of Equity.** — A consideration not emphasized very strongly in the cases cited in the latter part of the preceding section, but apparently sufficient of itself to turn the scale in favor of the doctrine which they announce, is that, under the peculiar circumstances

[1] In Commonwealth *v.* Susquehanna & Delaware River R. Co. (1888), 122 Pa. St. 306; s. c. 15 Atl. Rep. 448; 36 Am. & Eng. R. R. Cas. 269, the court said, in the course of its opinion: "If the title (to the corporate property) had been pledged or conveyed to trustees before the seizure (on execution), the defendant corporation has only an equity of redemption in the property mortgaged or conveyed." The consequence here predicated of the execution of an ordinary mortgage would doubtless not be admitted in the States where the lien theory, pure and simple, is accepted. But in the absence of some statute expressly declaring a trust deed a mere hypothecation, it would seem that, so far as regards its effect on the legal title, it must be considered as the equivalent of a common-law mortgage.

[2] Coe *v.* McBrown (1864), 22 Ind. 252. The trial judge, whose judgment was affirmed without comment in that case, cites Coe *v.* Pennock, *supra*, but seems to have assumed that the effect of the statute making the equity of redemption a leviable interest was to do away with the special reason for drawing the proceedings into a court of equity. This can scarcely be regarded as an indisputable proposition, but the obligation imposed on the purchaser by the ruling was doubtless a full protection to the bondholders.

involved in the adjustment of conflicting rights to railroad property, a court of equity is, as a general rule, the only forum where complete justice can be done to all the parties in interest. The unsatisfactory consequences from this point of view, of allowing a judgment creditor to sell a part of the mortgaged property, without reference to the claims of other creditors, are very clearly brought out in the opinion of Mr. Justice McLean, in delivering the judgment of the lower court in the case of Pennock *v.* Coe,[1] *supra.* He said: "There are three insuperable objections against such a procedure: (1) A sale on execution would convey to the purchaser no exclusive right to the property sold. (2) Such a sale would not divest the equitable rights of the bondholders. (3) The claim must be prosecuted in equity, where all who have an interest in the subject-matter may be made parties. In equity only can the rights of the parties be adjusted."[2]

That the learned justice intended to lay down the doctrine that the inadequacy of legal remedies was, apart from any question of the impairment of the security, a sufficient ground for enjoining an execution sale of the mortgaged personalty of a railroad company is, we think, clearly shown by the remark which follows the above citation: "And this is especially the case where the property mortgaged is inadequate to the payment of all the creditors. In addition to these considerations, from the nature of the property levied on it could not be separated from the road without suspending in whole or in part its operations. And what can be more unjust than this to the other bondholders? The operation of the machinery on the road in the transportation of passengers and freight constitute its chief value. The railroad, like a complicated machine, consists of a great number of parts, a combined action of which is essential to produce revenue. And as well might a creditor claim the right to levy on and abstract some essential part from Woodworth's planing machine, or any other combination of machinery, as to take from a railroad its locomotives or its passenger cars. Such an abstraction would cause the operations to cease in both cases."

[1] See Coe *v.* Pennock (1857), 5 Fed. Cas. 1172, Case No. 2942; s. c. 2 Redf. Am. Ry. Cas. 673; 6 Am. L. Reg. 27.

[2] The same judge, in a case decided about the same time, states the same principle somewhat more succinctly, as follows: "When property is purchased and placed upon the road, no lien being taken by the seller, it becomes subject to the mortgage lien on the road, so that it is not liable to an execution, except under the mortgage; and existing liens on the road can only be adjusted by a court of equity." Williamson *v.* New Albany, etc. R. Co. (1857), 1 Biss. 198. In Eckfelt *v.* Starr (1864), 5 Phil. 497, an injunction against an execution sale of railroad personalty was denied on the ground that the Interpleader Act of Pennsylvania furnished the trustees with an adequate legal remedy for the assertion of their rights.

§ 345. **Public Interest in Operation of Railroad a Ground for Interference of Equity.** — Still another aspect of the question which tends to support the same view is that the restraining power of a court of equity seems to be absolutely necessary for the purpose of giving time in each case to determine whether the sale of the property levied upon will prejudice the public, whose interests in the continued operation of the road are, as is shown in another part of this treatise,[1] paramount for some purposes even to those of secured creditors. The presumption certainly is that any severance from the property of articles covered by the mortgage, and coming under the head of appurtenances, will cripple the company to some extent. Is it not more consistent with the view ordinarily taken as to the *quasi* public character of the functions of a railroad company, to require a judgment creditor to overcome that presumption before he shall be allowed to take final action on his judgment, than to throw the burden of proof on the mortgagor?

§ 346. **Injunction to restrain Levy upon Net Revenues specifically appropriated to Payment of State Loan.** — Where the effect of a statutory mortgage giving the State a lien on the tolls and revenues of a canal company is specifically to appropriate, in so far as it is not required for current expenses, the money derived from that source to the payment of a loan made by the State, the right which unsecured creditors ordinarily have to levy on the corporate income as long as the mortgagees are out of possession does not exist, and an attempt to make such a levy will be restrained by an injunction, unless the debt for which the judgment was obtained is one for current expenses.[2]

In an earlier case in the Maryland court the rights of the State to restrain the attachment of the revenues pledged under the same statute was also considered, and the same conclusion was arrived at. The injunction was asked on the ground that the moneys attached were required to keep the canal in proper repair, as the company had expressly stipulated to do. The court said that this part of the income was as much protected as the net earnings, since upon its use depended both the vitality of the canal as a public and profitable improvement, and also the ultimate security of the State as a creditor. The right of the State to see to the

[1] Chapter on receivers.

[2] Macalaster's Admrs. *v.* Maryland (1885), 114 U. S. 598; s. c. 5 Sup. Ct. Rep. 1065. This case raises a somewhat different question from that of the susceptibility of railroad personalty generally to levy, but the principle on which it was decided, viz., that the security of the State and of the trustees for bondholders secured by a prior mortgage of the canal would be affected by a levy which diverted the money in suit from its lawful object, is quite analogous to that which underlies Pennock *v.* Coe (1859), 23 How. 117, and similar rulings cited above.

proper application of the revenues to the repairs, as well as to the other legitimate objects contemplated by the legislation relating to the property, could not, it was said, be interfered with by the application of the technical rules which govern the ordinary relation of mortgagor and mortgagee.[1]

§ 347. **Injunctions against Execution Sales of Realty.** — For practical purposes the conflict of opinion noticed above is confined to cases where personalty is levied upon. So far as regards the real estate of a railroad company acquired for railroad purposes, any attempt of a judgment creditor to sell a portion of it must, in the nature of the case, be prejudicial to a bondholder, and it seems to be an established doctrine that the sale will, as a matter of course, be stayed, so as to compel the creditor to obtain such relief as he may be entitled to by applying to a court of equity. Impairment of the security is a necessary result of a breaking up a property which the intention clearly is to have operated as an entirety for the benefit of the lienors. The unity of the mortgaged realty of a railroad company or other corporation of similar character may be threatened in two ways by a levy. It may be made on an entire division of the road, including both the land occupied by the track and that required for the convenient transaction of its business.[2]

An injunction is especially appropriate where the sale of a section of the road is being pressed by numerous creditors; for a court of equity then has a double foundation for the exercise of its jurisdiction, viz., the prevention of a multiplicity of suits, and the prevention of irreparable damage to the other creditors whose interest it is that the road should be sold as an entirety, and, in the meantime, that it should be operated throughout its entire length, for the benefit of all concerned, so that, when it is sold, it may bring its full market value.[3]

[1] Brady *v.* State (1866), 26 Md. 290. See also Brady *v.* Johuson (1892), 75 Md. 445; s. c. 26 Atl. Rep. 49.

[2] In Du Pont *v.* Bushong (1875), 1 W. N. C. (Pa.) 378, an injunction was sought in a federal court by a bondholder to restrain another bondholder from levying on and selling that part of the property of a railroad company which was subject to the jurisdiction of the court. The point emphasized by the applicant's counsel was that the value of the property would be greatly diminished if it was broken up. The court said he had no doubt that the circumstances presented a case for equitable interference, but, having some doubt as to the jurisdiction of the court under the Judiciary Act, suggested that some amicable arrangement should be made.

[3] Noble Bros. *et al. v.* State of Alabama (1871), 43 Ga. 466. Compare also the remark of the court in South Carolina R. Co. *v.* Peoples' Sav. Inst. (1879), 64 Ga. 18, to the effect that a court of equity, on a proper case being made, would perhaps restrain judgment creditors of a company having property both beyond and within the State limits from levying on the latter portion, and order the whole road to be sold. But this question was not directly presented.

Or the judgment creditor may be undertaking to sell merely a particular piece of land belonging to the company and essential to the exercise of its franchises.[1]

Wherever an injunction will be granted to restrain an execution sale of real estate, the same relief is of course appropriate where a levy is made on personalty which is a fixture; but, as we have already seen, the courts are not entirely in harmony as to what property is embraced in that term. (See Chap. IX.)

§ 348. **Injunctions against Execution Sales where Trustees have gone into Possession.** — In this case they can, of course, restrain an execution sale of all corporate property covered by an after-acquired property clause.[2]

Particularly must this be so where the trustees hold under a decree which authorizes their possession, and obligates them to account to the court for the faithful performance of their duties. The property being then in the custody of the court, an injunction will, upon familiar principles, be granted to restrain any proceedings to enforce a judgment, unless the leave of the court is first obtained for that purpose.[3]

§ 349. **Injunctions to prevent a Bondholder from obtaining an Inequitable Preference over his Co-bondholders.** — If a bondholder

[1] In Gue *v.* Tide Water Canal Co. (1860), 24 How. 257, the company was granted an injunction to restrain the sale of a part of its property on this ground. "It would," said Chief Justice Taney, "be against the principles of equity to allow a single creditor to destroy a fund to which other creditors had a right to look for payment, and equally against the principles of equity to permit him to destroy the value of the property of the stockholders, dissevering from the franchise property which is essential to its useful existence." It was further said that the court did not deem it proper to express any opinion as to the right of such a creditor in some other form of judicial proceeding to compel the sale of the whole property for the payment of his debt. If so, his remedy was in a court of chancery, where the priorities of all the creditors might be protected, and the corporate property disposed of to the best advantage for the interests of all concerned. The reasoning of the court is perfectly general, and it can scarcely be doubted that the injunction would have been granted at the suit of a bondholder. In fact, it was cited as an apt authority in the recent case of Brady *v.* Johnson (1892), 75 Md. 445; s. c. 26 Atl. Rep. 49, where one of the grounds assigned for restraining a sale of certain realty belonging to a canal company was that it was essential for the operation of the canal, the petition for the injunction being filed by the trustees.

In Coe *v.* Columbus, Piqua, & Ind. R. Co. (1859), 10 Ohio St. 372, the judgment creditor had undertaken to levy on a part of the road. In the appellate court his right to do so was not pressed, and the discussion centred upon the extent of his rights in regard to the personalty. But it was observed in passing that, being an interest in real estate, held for the sole and exclusive purpose of the exercise of a franchise, the road could not be alienated by the corporation, and, of course, would not be liable to execution. For a list of the authorities supporting the general principle here referred to see Brunswick, etc. Co. *v.* United Gas Co., 35 Am. St. Rep. 466.

[2] Felton *v.* Potomac Ins. Co. (1873), 4 Del. Ch. 573. Compare Palmer *v.* Forbes (1860), 23 Ill. 301.

[3] Brady *v.* Johnson (1892), 75 Md. 445; s. c. 26 Atl. Rep. 49.

levies upon property covered by the after-acquired property clause, any of his co-bondholders may file a bill to restrain the sale and procure a decree that the property is exempt from sale under that or any other execution that may be issued on the same judgment.[1]

So also an injunction will be granted to the bondholders secured by a first mortgage to restrain a bondholder secured by a second mortgage from selling on execution property so covered, both because it would disturb the *pro rata* distribution in case of a deficiency, and give him an inequitable preference over his associates, and also because it would have the effect of prejudicing the superior equity of the bondholders secured by the prior mortgage.[2]

It would seem, however, that bondholders may attach the mortgaged property in an action at law, if they allege that the residue of the secured debts have been paid, and make the trustees or legal title-holders parties to the proceedings.[3]

§ 350. **Execution Sale not enjoined at the Instance of the Mortgagor.** — The railroad company itself cannot shield its property from execution by the allegation that it is covered by sundry mortgages. Whatever protection the mortgagee may be entitled to must be asserted by itself, and cannot be considered in proceedings instituted by the company to enjoin the sale.[4]

The mortgagor may, however, take action when an injunction is asked for on the ground that the property to be sold is essential for the useful existence of the franchise.[5]

[1] Philadelphia, Wilm. & Balt. R. Co. *v.* Woellper (1870), 64 Pa. St. 366; Commonwealth *v.* Susquehanna & Delaware River R. Co. (1888), 122 Pa. St. 306; s. c. 15 Atl. Rep. 448; 36 Am. & Eng. R. R. Cas. 269.

[2] Pennock *v.* Coe (1859), 23 How. 117.

[3] Martin & Meriwether *v.* Mobile & Ohio R. Co. (1870), 7 Bush (Ky.), 116.

[4] Boyd *v.* Chesapeake & Ohio Canal Co. (1860), 17 Md. 195.

[5] Gue *v.* Tide Water Canal Co. (1860), 24 How. 257; Northern Pac. Co. *v.* Shimmell (1886), 6 Mont. 161; s. c. 9 Pac. Rep. 889; 24 Am. & Eng. R. R. Cas. 1. *Contra*, see Midland Ry. Co. *v.* Stevenson (1891), 130 Ind. 97; s. c. 29 N. E. Rep. 385, where the court denied a petition by the mortgagor company for an injunction, asked on double ground: (1) that the rolling-stock levied upon was realty, and (2) that it was property essential to the exercise of the franchise. The discussion of these vexed questions was deemed unnecessary for the decision of the case, the position being taken that a company not insolvent, and not unable, but merely unwilling, to pay a debt had no standing in a court of equity to have its collection enjoined. "If the company was insolvent," said the court, "and this suit had been instituted by the trustees for the bondholders, as was the case in Titus *v.* Mabee (1861), 25 Ill. 257, and Titus *v.* Ginheimer (1861), 27 Ill. 462, a different question would be presented." This decision, it is submitted, is contrary to authority. It is doubtless true that the question whether certain personalty is a fixture cannot be raised, as against a creditor, by the mortgagor itself, but the question whether personalty is protected from levy as being essential to the exercise of the franchise, so far from being one which cannot be raised by the owner, is one which has almost always, in the numerous cases on the subject, been raised by such owner. See the list in the note to Brunswick Gaslight Co. *v.* Brunswick Gas Co., 35 Am. St. Rep. 405. Whether such property is or is not mortgaged is a matter entirely outside the issue when exemption from levy is claimed on this ground.

§ 351. **A Federal Court has no Jurisdiction to restrain an Execution Sale under the Process of a State Court.** — Under 1 U. S. Stat. L. 335, § 5, such an injunction is illegal, and a federal court is powerless to act, in spite of the doctrine of Pennock *v.* Coe, *supra.*[1]

§ 352. **Injunctions in Aid of Holders of Income Bonds.**[2] — It has been shown in another part of this treatise (Chap. XV.), that, as long as the company is permitted to remain in possession of the estate, the holders of bonds secured by a general mortgage which specifically pledges the income amongst other kinds of property have no right to interfere with the use of the earnings by the mortgagor.

Doubtless an abuse of the discretion thus reserved to the company would furnish a ground for the interposition of a court of equity, but the circumstances under which relief against a positive misapplication of the funds would be granted where the income is only a part of the security do not seem to have been judicially considered.

The question has, however, been raised in regard to income bonds which expressly obligate the company to devote whatever surplus of the earnings remains, after paying the operating expenses, to keeping down the interest. The holders of such bonds may file a bill for an accounting and enjoin any misapplication.[3]

But no misapplication is shown where the principal only of income bonds is secured by the mortgage, the payment of interest

[1] Ruggles *v.* Simonton (1872), 3 Biss. 325.

[2] Dividends on preferred stock must be paid after interest on bonds. See chapter on reorganization.

[3] Barry *v.* Missouri, Kans. & Tex. R. Co. (1885), 27 Fed. Rep. 1. There the court refused to allow the company to charge against income, for any period during the life of the mortgage, a liability incurred on account of old indebtedness existing before the mortgage was created, or arising from a loss incurred by the sale of bonds issued to pay off old indebtedness.

The basis on which an accounting in such a case will be had was thus stated by Wallace, J.: "The expenses defrayed or incurred in producing the earnings for a given interest period are the only charges which can enter into the income account for that period, except the payment of interest on prior incumbrances, as stipulated by the terms of the mortgagor, and the company cannot charge against income for any period during the life of the (income) mortgagor, a payment or liability incurred on account of old indebtedness existing before the mortgage was created, or arising from a loss incurred by the sale of bonds issued to pay off old indebtedness."

Afterwards, in the same matter, this judge held that if the court had seen fit to pay a higher rate of interest than needful upon prior incumbrances, it could not charge the difference against the income to the injury of the bondholders, in direct contravention of the provisions of the mortgage securing the income bonds. He also sustained the rejection by the master of a lump sum of money paid to a company whose road had been leased by the mortgagor as a compensation for what was styled an "allowance" to the lessor company, on adjustment of earnings diverted from its line to the lessor's railway. The master had disallowed it as not falling within the category of expenses incurred in operating and keeping in repair the road as covered by the income mortgage. Barry *v.* Missouri, Kans. & Tex. R. Co. (1888), 34 Fed. Rep. 829; s. c. 4 Ry. & Corp. L. J. 198.

being subject to the condition that "the net earnings" for each year should be sufficient to pay it, and the amount of the net earnings left to be determined by the board of directors, and the mortgagor, having under the mortgage the right "to retain the free and uncontrolled use, enjoyment, and management" of the property, so long as no default is made in payment, according to the terms of the bonds, expends money in carrying out a lease, and thereby absorbs earnings which would otherwise be available for the payment of interest. So far as that interest is concerned, the income bondholders are, in such a case, simply general creditors, having no lien or right other than to have it paid out of the proper fund, *i. e.* "the net earnings." The power of the company to change the condition of the road by additions, extensions, or improvements, consistent with the purposes of its corporation, is not restricted by provisions of this character. The parties contemplate a line of active and efficient railroad managed in the usual manner according to the discretion of the company's directors, not one in discharge or liquidation; and the directors, therefore, have the right to use the earnings of the corporation for such improvements or other lawful purposes in its business as they may think best.[1]

§ 353. **Right of Bondholders to maintain a Suit to enjoin Enforcement of a Railroad Commission Law.** — In a recent case the bondholders of several Texas railroads filed bills against the railroad companies, the State railroad commissioners, and the Attorney-General, alleging that the interest on the bonds was not being paid, that the companies were willing and anxious to meet all their obligations to the complainants, but were unable to do so owing to the action of the railroad commissioners in fixing unprofitable rates. The statute under which those officials undertook to prescribe the rates complained of was asserted to be unconstitutional, and the petition of the bondholders was for an injunction restraining its enforcement. They were held to have shown a sufficient interest in the road to enable them to maintain the suit.[2]

[1] Day *v.* Ogdensburgh & Lake Champlain R. Co. (1887), 107 N. Y. 129; s. c. 13 N. E. Rep. 765.

[2] Mercantile Trust Co. *v.* Texas & Pac. Ry. Co. (1892), 51 Fed. Rep. 529.

The rights of a trustee to maintain such a suit are fully recognized in the recent case of Reagan *v.* Farmers' Loan & Trust Co. (1894), 154 U. S. 362; but the question was discussed merely with reference to the extent of the power of the courts to interfere, and it was taken for granted that they had a sufficient interest in the matter. A stockholder has also a right to bring a suit for the same purpose: Tilley *v.* Savannah, Florida, & Western R. Co. (1881), 5 Fed. Rep. 641; s. c. 4 Woods, 427; where the injunction was dissolved on the broad ground that the legislature has power to modify railway rates. Since the decision in Reagan *v.* Farmers' Loan & Trust Co., *supra*, this case must be taken

with the qualification that the power cannot be used so as to destroy the value of the property altogether.

The following cases from the English courts illustrate the principles discussed in this chapter: —

In England, prior to the Railway Companies Act of 1867, a judgment creditor might prevent a company from carrying on business at all by seizing all its rolling-stock, and a debenture-holder could do nothing to prevent the seizure, for he had no specific lien upon the property of the company, under the Companies Clauses Act, but merely the company's "undertaking" *as a going concern.* Gardner *v.* London, C. & D. Ry. Co. (1866), L. R. 2 Ch. App. 201. By the act of 1867, however, the judgment creditor was deprived of his power, for which was substituted a power to obtain a receiver and manager of the line. *In re* Eastern & Midlands Ry. Co. (1890), L. R. 45 Ch. D. 367; Russell *v.* East Anglican Ry. Co. (1850), 3 Mac. & G. 124. A dock company, although not a railway company in the ordinary sense of the term, was held to be a "company" within section 3 of the act of 1867, as being a part of the plant of a railway, notwithstanding that the railway was merely an ancillary and subordinate part of the whole undertaking, and the dock plant was protected by injunction from seizure under an execution. The Great Northern R. Co. *v.* Tahourden (1883), 13 Q. B. Div. 320. Once a railway is opened for public traffic, the protection of the act arises, and continues, although the railway is afterwards closed for traffic. The Midland Waggon Company *v.* The Potteries S. & N. W. Co. (1880), 6 Q. B. Div. 36. Where the security is endangered, a debenture-holder may obtain the appointment of a receiver and manager of a railway, although no interest is due on the debentures, and the time for payment has not arrived. Edwards *v.* Standard Rolling Stock Syn. (1893), 3 R. 226; Thorn *v.* Nine Reefs (1892), 67 Law Times, 93. In a winding-up proceeding, where there appears a probability that the property comprised in the debenture will have to be realized by sale in the near future, the court will appoint a receiver and manager of the business of the company, though no winding-up order has yet been made and nothing has become actually due upon the debenture. *In re* Victoria Steamboats, Limited (1897), 66 L. J. Ch. 21. A debenture of a tramway company governed by the Tramways Act of 1870 does not entitle the holder to have the "undertaking" sold, or a manager as well as a receiver appointed. Marshall *v.* South Staffordshire Tramways Co. (1895), 64 L. J. Ch. 481, the court disapproving a number of prior decisions tending to the contrary. Nevertheless, where such a receiver and manager had been appointed prior to the decision in the case last cited, his acts were recognized as valid and binding. Pegge *v.* Neath District Tramways Co. (1895), 64 L. J. Ch. 737. Where the proceeds of chattels of a company sold under an execution have not been handed over to the execution creditor, the holder of a debenture which creates a charge on the chattels may, on behalf of himself and the other debenture-holders, intervene and claim the proceeds, if the amount secured by the debenture is presently payable. Taunton *v.* Warwickshire (Sheriff), (1895), 1 Ch. 734, affirmed (1895), 2 Ch. 319.

Injunction proceedings and kindred remedies are available to debenture-holders to the same extent in England as in this country. "The court, by coercion of the person within its jurisdiction, is enabled in effect to exercise jurisdiction over the property of that person wherever it may be situate." Jessel, M. R. *In re* Longdendale Cotton Spinning Co. (1878), L. R. 8 Ch. Div. 152. The appointment of a receiver as a preventive remedy is the remedy most frequently resorted to as being the most appropriate in the large majority of cases. A receiver will be appointed on grounds of insolvency, although the principal of the debenture is not immediately payable: McMahon *v.* North Kent Ironworks Co. (1891), 2 Ch. 148; or where there is danger of the property which is the subject of the debenture being disposed of during the progress of the trial, otherwise than in the ordinary course of business: Hubbuck *v.* Helms (1887), 56 L. T. R. 232; and in a variety of other cases in which the security of the debenture-holders is jeopardized: Yorkshire Ry. Wagon Co. *v.* Maclure (1882), 21 Ch. D. 309; *In re* Colonial Trust Corporation Co. (1879), 15 Ch. D. 473.

CHAPTER XVI.

REMEDIES OF BONDHOLDERS FOR THE ENFORCEMENT OF BONDS.

REMEDIES IN GENERAL.

§ 354. **Introductory.** — The remedies available to bondholders[1] for the enforcement of their rights may be divided into three classes: —

1. Those which they have in common with all creditors, whether secured or unsecured. This class includes the common-law remedies by action of assumpsit on the debt itself, or of covenant on the bond, and the equitable remedy of sequestration of profits, wherever that is appropriate.

2. Those which are incident to the mortgage contract itself, without regard to any special provisions therein. This class includes the legal action of ejectment (except in jurisdictions where the doctrine that a mortgage is merely a lien has been adopted), and the equitable remedies of sequestration of profits and suits for foreclosure and sale.

Various local modifications of the remedies in this class have been introduced in some States. But these it is not material to notice in the present connection.

3. Those which are provided by the instrument for the purpose of enabling the bondholder to obtain a more speedy enforcement of his lien than is possible by proceedings taken in the ordinary manner. This class includes the summary powers of entry and sale, which the mortgage itself usually authorizes the trustee to exercise, upon certain specified conditions, in behalf of the beneficiaries.

[1] For remedies of bondholders secured by statutory liens in the nature of mortgages, see Chap. XIII.

The above statement is based on the following passage of the opinion in Gilman *v.* Illinois & Mississippi, etc. Tel. Co. (1875), 91 U. S. 603, in which the historical reason for the existence of several concurrent remedies is also glanced at: "The civil law is the spring-head of the English jurisprudence upon the subject of these securities (conveyances subject to defeasance). Originally, according to that jurisprudence, mortgages of the class to which those here in question belong vested the fee, subject to be divested by the discharge of the debt at the day limited for its payment. If default was then made, the premises were finally lost to the debtor. In the progress of time more liberal views prevailed, and the debt came to be considered as the principal thing, and the mortgage only as an incident and security. In the present state of the law, where there is no prohibition by statute it is competent for the mortgagee to pursue three remedies at the same time. He may sue on the note or obligation, he may bring an action of ejectment, and he may file a bill for foreclosure and sale."[1]

§ 355. **Bondholders not restricted to any Single Remedy.** — The several remedies available for the enforcement of the mortgage may be pursued concurrently or successively,[2] and in any order that the mortgagee may think fit.[3]

This choice of remedies is of course narrowed where the right of action on the bonds is barred by the Statute of Limitations. In that case resort must be had to the remedy on the mortgage, which is not barred by any lapse of any shorter period than that sufficient to raise the presumption of its discharge.[4]

The special illustrations of the general rule afforded by those cases which hold that special remedies created by the agreement of the parties are cumulative upon the remedy by foreclosure in a court of equity are referred to below.

§ 356. **General Powers of a Court of Equity for the Relief of Bondholders.** — The fact that an ordinary railroad mortgage is drawn

[1] Some useful information as to the remedies of mortgagees will be found in an article in 2 Mo. West. Jur. 641. See also 2 Redfield's Law of Railways, 484.

On injunction by debenture-holders to restrain payments to bondholders, see The Governments Stock, etc. Co. *v.* The Manila Ry. Co. & Others (1897), 1 L. R. App. Cas. 81. On the character of a debenture-holder's action, see Madeley *v.* Ross (1897), 1 Ch. Div. 505.

[2] Macon & Augusta R. Co. *v.* Georgia Railroad & Bkg. Co. (1879), 63 Ga. 103. For a short sketch of the law regulating the enforcement of powers of sale, and a statement of the reason why that remedy is regarded as concurrent with that of foreclosure, see 16 Cent. L. J. 247.

[3] McAllister *v.* Plant (1876), 54 Miss. 106; s. c. 17 Am. Ry. Rep. 183.

[4] Smith's Execrs. *v.* Washington City, Va. Midl. & Great Southern R. Co. (1880), 33 Gratt. (Va.) 617.

in the form of a deed of trust brings such instruments within the rule, that a court of equity will assume jurisdiction of a conventional trust and direct its administration, on the application of the trustee or a party in interest, where there is any difficulty or complication likely to arise in the execution of the trust, or any question or dispute as to the powers or duties of the trustee, or as to the rights of the parties beneficially interested in the trust.[1]

Even if a court of equity has no general jurisdiction over mortgages, as was formerly the case in Pennsylvania, where the enforcement of such liens was left to the common law and statutory remedies, yet if a mortgage creates a trust and provides that the power of sale is to be exercised by the trustee in certain contingencies, he may be controlled, restrained, and directed by such a court, at the suit of a party standing in the relation of *cestui que trust*, the rule for his guidance being derived from the instrument itself.[2]

The fact that a discovery is asked may be a sufficient ground for the interposition of equity in a case where a bill would otherwise be dismissed. Thus, although a statement that the defendant, a reorganized company, is about to issue its own bonds to certain holders of the first-mortgage bonds issued by the original company, the bill not showing that the new bonds were to be secured by mortgage, does not lay a ground for equitable jurisdiction in favor of the complainant, a holder of a first-mortgage bond, who had agreed to come in under the reorganization scheme; yet equity will take cognizance of such a suit where there is also an allega-

[1] Northern Central Ry. Co. *v.* Keighler (1868), 29 Md. 572.

[2] Bradley *v.* Chester Valley R. Co. (1860), 36 Pa. St. 141. Compare Mendenhall *v.* Westchester & Philadelphia R. Co. (1860), 36 Pa. St. 145; Youngman *v.* Elmira & Williamsport R. Co. (1870), 65 Pa. 278. Before the statute of 1862 was passed (1 Brightly's Purdon's Dig. 593), a court of equity in Pennsylvania had no power to decree a sale of the mortgaged property at the instance of the mortgagee, even though the mortgage was in the form of a deed of trust to secure bonds. Ashhurst *v.* Montour Iron Co. (1860), 35 Pa. St. 30. The constitutionality of that act was attacked, so far as it was made applicable to mortgages before its passage, in McElrath *v.* Pittsburg & Steubenville R. Co. (1867), 55 Pa. St. 189; but it was held that this objection could not be sustained, since it merely provided a new remedy for the mortgagor's breach of contract. The jurisdiction thus conferred on the Supreme Court was taken away by the constitution of 1874. See Fargo *v.* Oil Creek & Alleghany City Ry. Co. (1875), 81 Pa. St. 266, where a bill was filed in the Supreme Court for a decree to sell, etc. One of the prayers was for an injunction to restrain the defendants from selling, or in any manner disposing of, the property covered by the mortgage. *Held*, that the injunction was merely incidental to the sale, the substantial thing asked for, and did not therefore bring the bill within the jurisdiction of the Supreme Court. The decree of sale was accordingly vacated.

tion that the defendant refused to disclose what the scheme was. "The complainant," said the court, "is entitled to this information, and it is also clear that we cannot say whether her rights are legal or equitable until such discovery shall have been obtained." [1]

In an oft-cited New Jersey case, decided when questions arising under corporate mortgages and trust-deeds were still new, it was argued that the remedy of the mortgagee was confined to the sequestration of the profits of the business. The court rejected this doctrine, and held that the legislature, by giving authority to the company to execute a mortgage, intended to invest the mortgagee with all the powers incident to such an instrument, the power to foreclose and sell being one of those powers.[2]

The remedy of sequestration under the general powers of a court of equity is very rarely, if ever, resorted to for the relief of railroad bondholders, except for temporary purposes, as where the property is placed in the hands of a receiver with a view to foreclosure and sale. The rights and liabilities of the various parties in interest under such circumstances are reviewed in the chapters relating to receivers, *post*.

A remedy in the nature of sequestration is also given by most railroad mortgages, those instruments usually embracing provisions stipulating that the trustees may, if certain specified conditions are broken by the mortgagor, enter into possession of the road and operate it for the benefit of the bondholders. The legal relations arising from a resort to this remedy are discussed below, and in the chapter on trustees.

Provisions similar to those inserted in mortgages for this purpose are usually found in those statutes which create a lien in favor of the State to secure it for its loan of its own bonds to the company, or for its indorsement of the company's bonds.[3]

§ 357. **State when not a Trustee of Earnings for Benefit of Junior Mortgagees.** — A State which subscribes for the majority of the stock in a railroad corporation organized by special statute does not by such subscription become a trustee of the earnings of the

[1] Midland Railway Co. *v.* Hitchcock (1881), 34 N. J. Eq. 278; s. c. 4 Am. & Eng. R. R. Cas. 278.

[2] Willink *v.* Morris Canal & Bkg. Co. (1843), 4 N. J. Eq. 377.

[3] See, for example, the statutes discussed in Tompkins *v.* Little Rock & Fort Smith Ry. Co. (1888), 125 U. S. 109; s. c. 8 Sup. Ct. Rep. 762; Florida *v.* Anderson (1875), 91 U. S. 667.

Compare the remarks of Judge Woodward in Bradley *v.* Chester Valley R. Co. (1860), 36 Pa. St. 141, as to the recognized legal remedies of mortgagees, wherever the common-law and chancery jurisdictions have not been restrained and regulated by statute.

road for the benefit of the holders of bonds secured by statutory mortgages thereafter declared upon its stock. Hence, if the road is leased to another company for a rent sufficient only to pay the interest upon a first mortgage so declared, a bondholder secured by a junior mortgage of the same kind cannot maintain a bill against the lessee company, to compel it to account for the excess of the earnings of the leased road over the stipulated rent, upon the theory that the State, by the hypothecation of its stock, impliedly assumed a fiduciary relation to the complainant and other bondholders, and agreed to exercise its control as a majority stockholder of the lessor company, so as to preserve the earnings for the benefit of their bonds, thus making such earnings a trust fund which the bondholders could follow into the hands of any one receiving them with notice. "Such a case is not distinguishable in its legal aspects from one where an individual who is a majority stockholder in a corporation has hypothecated his shares to a creditor as security for a loan. In such a case it may be assumed that both parties to the transaction understand at the time that the value of the security is to depend upon the financial prosperity of the corporation; but no promise or duty can reasonably be implied from that understanding that the shareholder who has mortgaged his shares is to use his power of control in the corporate affairs exclusively in the interest of the mortgagor, or is not to consent to or promote any scheme or undertaking in the conduct of its business which is within the scope of its legitimate functions, and which he may believe to be expedient and proper." [1]

§ 358. **Chancery Powers of Federal Courts are independent of State Laws.** — The doctrine that the jurisdiction of federal courts in equity coincides and is coextensive with the jurisdiction of chancery in England, and cannot be limited and restrained by State laws, has been repeatedly recognized.[2]

Thus a controversy between a *cestui que trust* and a trustee respecting the latter's management of the trust estate belongs peculiarly to a court of chancery, and is therefore within the jurisdiction of the federal courts, when the proper parties are before them, and the required sum is in dispute; nor can they be deprived

[1] Gibson *v.* Richmond & Danville R. Co. (1889), 37 Fed. Rep. 743, per Wallace, J.

[2] Lorman *v.* Clarke (1841), 2 McLean, 568; Boyle *v.* Zacharie (1837), 6 Pet. 635, 658; Robinson *v.* Campbell (1818), 3 Wheat. 212; United States *v.* Howland (1819), 4 Wheat. 108, 115; Neves *v.* Scott (1851), 13 How. 268, 271; Noonan *v.* Lee (1860), 2 Black, 499; Payne *v.* Hook (1868), 7 Wall. 425; Pratt *v.* Northam (1828), 5 Mason, 95, 105; Chapman *v.* Borer (1880), 1 McCrary, 49.

of this jurisdiction, or any portion of it, by its absorption, through State legislation, into any State tribunals, or by any attempted transfer of the subjects of litigation from one department of jurisprudence to another.[1]

§ 359. **Statutes affecting Remedies only are not unconstitutional, as impairing the Obligation of Contracts.**[2] — The legislature may, therefore, vary or add to or diminish the different modes of foreclosure as to existing mortgages, provided no essential right that existed before is taken from either of the parties to the mortgage. If the distinctive features of the law regulating foreclosures when the mortgage is made are, on one side, a right to redeem within three years, and on the other a mode of foreclosure of which reasonable notice must be given to the mortgagor, a foreclosure is valid which is made under a subsequent statute which preserves those rights, but prescribes new forms of procedure for the enforcement.[3]

[1] Parsons *v.* Lyman (1863), 5 Blatch. 170.

[2] Bronson *v.* McKinzie (1843), 1 How. 311.

[3] Kennebec & Portland R. Co. *v.* Portland & Kennebec R. Co. (1871), 59 Me. 9. In this case the original mortgagor filed a bill to be allowed to redeem, contending that the statute law of Maine, as it existed in 1852, was not applicable to railroad mortgages; that, from the peculiar nature of those instruments, there could be no foreclosure of them except by bill in equity without a special legislative provision therefor; and that this right to foreclose by bill in equity was a vested one, which entered into the contract.

Under these circumstances, it was argued, a subsequent statute prescribing a new and exclusive proceeding for the foreclosure of such mortgages necessarily violated the obligation of the contract. The majority of the court adopted the view that, as the courts of Maine had no general equity powers, the rights of mortgagors and mortgagees were merely what the legislature had made them, and that the mortgagee had therefore no "equity of redemption," as that term is understood in England, and in the States which have adopted the English doctrine on the subject, whether by statutes dealing directly with the remedy, or by statutes investing courts with powers analogous to those exercised by the English Court of Chancery. Barrows and Tapley, JJ., dissented. The latter filed an elaborate opinion, in which he took the ground that there was nothing in the words of the statute to show that it was intended to act retrospectively, and much to indicate the reverse; that the prior statute in force when the mortgage was executed did not reach a railroad mortgage, and was not designed to do so; that consequently the only remedy existing when the contract was entered into by which the right of redemption could be foreclosed was by application to a court of equity; and that the courts of Maine had power to deal with cases under the general legislation defining their authority. The learned judge also took the ground that whether the equity powers of those courts were or were not sufficient, treating the suit as one for foreclosure merely, their powers in regard to trusts were such as to furnish an adequate and complete remedy for the enforcement of rights springing from a conveyance in trust. The later statutes, therefore, having in no way modified the rights of the complainants, the trustees still held the title in trust and were answerable as such.

In Sullivan *v.* Portland & Kennebec R. Co. (1874), 4 Cliff. 212, it was held that this judgment as to the validity of this foreclosure was binding on a federal court.

The statutes of Maine (1876, ch. 122)

The Supreme Judicial Court of Maine, in the case last cited, have said on the subject of foreclosure: "Aside from the foreclosure proceedings authorized by the trustees, equity furnishes the best and perhaps now the exclusive forum for foreclosure of this class of mortgages. The ordinary method of foreclosure of mortgages on real estate is ill adapted to the foreclosure of railroad mortgages. The protection of all the large interests usually involved in the latter may require a receivership, or an injunction, or an order of sale, none of which can be accomplished by the ordinary proceedings for foreclosure, but can easily be provided for by the flexible processes of equity. The case of Kennebec & Portland Railroad *v.* Portland & Kennebec Railroad, 59 Maine, 1, holding otherwise, was decided when the equity powers of this court were limited, and is not applicable under the full equity powers now possessed."[1]

On the other hand, where a mortgagee has a fixed, certain, and definite right to a foreclosure under a bill in equity, and to a decree of the court for an absolute and immediate sale of the premises for the payment of his debt, the legislature cannot deprive him of this right by statutes creating a new equity of redemption after the sale, and abrogating the right to sell under

gave the benefit of the provisions of R. S. 1871, ch. 51, from §§ 47 to 70, to the holders of all mortgage bonds, whether the mortgage was foreclosed as provided in ch. 51, "or in any other legal manner;" and 1878, ch. 53, having made the same sections of ch. 51 of R. S. 1871 apply to and include all such mortgages, "in all cases in which the principal of said scrip or bonds shall have been due and payable for more than three years, and shall remain unpaid in whole or in part, in the same way and to the same extent as if the mortgage had been legally foreclosed." The bondholders of the Somerset Railway Company, there having been a default in payment of interest on their bonds for more than three years, by the votes of one-half in interest, had the Somerset Railway Company incorporated and took possession of the property, the votes of the stockholders of the Somerset Railway Company having also been cast in favor of the new organization. Under the provisions of the statutes the most of the bondholders surrendered their bonds in exchange for shares of stock at their face value. There was a sale of the equity of redemption under the mortgage under execution, and the railway company purchased it. The trustees under the mortgage afterwards instituted an action for foreclosure of the mortgage. The Supreme Judicial Court held that the action of the bondholders under the statutes amounted to a complete foreclosure of the mortgage; that the bondholders who had surrendered their bonds for stock were stockholders, and those who had not surrendered their bonds, shareholders in the Somerset Railway Company, and that the title of the latter to the property of the former company was absolute and complete, and enjoined the trustees against further proceeding in their foreclosure suit, and ordered them to convey their naked legal title to the newly organized railway company. Somerset Railway *v.* Pierce *et al.* (1895), 88 Me. 86; s. c. 33 Atl. Rep. 772.

[1] Somerset Railway *v.* Pierce *et al.* (1895), 88 Me. 86, 96, 97; s. c. 33 Atl. Rep. 772.

the decree, except where two-thirds of a value fixed by appraisers shall be offered at the auction sale.[1]

Where bondholders of a corporation, by a bill alleging the insolvency and unfitness of its trustee to serve the holders of bonds of the corporation, as well as its holding an adverse interest to them, have a receiver appointed, this is equivalent to a removal of the trustee. The bondholders then will be entitled to declare the principal of the bonds due in default of interest when provided for in the mortgage, and to foreclose the mortgage without any request of the trustee prior to beginning the action.[2]

§ 359 *a*. **Illustrative Cases on English Debentures.** — English bondholders secure to themselves a summary method of realizing upon their security by procuring to be executed along with their mortgage an instrument called a receivership deed, under which a receiver, to collect the rents and profits of the mortgaged premises to be applied in extinguishment of the debt, may be appointed without an application to court.[3]

Power of sale under the Conveyancing and Law of Property Act, 1881, which applies "to any charge, or any property, for securing money or money's worth," does not apply to limited companies formed under the Companies Act of 1862, and such companies can have that power only by express agreement.[4]

A debenture-holder has the right of an ordinary creditor to petition for a winding-up order under section 199 of the Companies Act of 1862, and he is not debarred from the exercise of that right by the circumstance that he has pursued another remedy, that, to enforce his security.[5] But a winding-up order will not be made where no good could result from it.[6]

Where, in an act of Parliament incorporating a company, it is stated that the construction of the works authorized by the act is of public advantage, the court will be reluctant to make an order to wind up the company, unless it is shown that there is no other process by which its difficulties may be overcome.[7]

[1] Bronson *v.* McKinzie, 1 How. 311.

[2] Clay *et al. v.* Selah Valley Irrigation Co. *et al.* (Wash., 1896), 45 Pac. Rep. 141.

Certain sections of an act of Parliament held not to prohibit an action by a mortgagee of the company to recover the principal due on it. Coleman *v.* Llanelly Ry. & Dock Co. (1867), 17 L. T. Rep. N. S. 86.

[3] Law *v.* Glenn (1867), 2 Ch. App. 634.

[4] Blaker *v.* Herts & Essex Waterworks Co. (1889), 41 Ch. D. 399.

[5] *In re* Burrough of Portsmouth, etc. Tramways Co. (1892), 2 Ch. 362.

[6] *In re* Barton upon Humber and District Water Co. (1889), 42 Ch. D. 585; *In re* The Company of Free Fishermen of Faversham (1887), 36 Ch. D. 329.

[7] *In re* Exmouth Docks Co. (1873), 17 Equity, 181; *In re* The Company of Free Fishermen, etc. (1887), 36 Ch. D. 329.

Where debenture-holders of a company, formed under a special act which gives them only one remedy, namely, the appointment of a receiver, with that remedy they must be content, and a petition to wind up, presented on their behalf, will not be sustained.[1]

The benefits of a personal judgment may be secured by debenture-holders, whereby they may avail themselves of any property not included in their security. Such a judgment may be recovered in an action by one holder on behalf of himself and the others, or rather the court will declare that the debenture-holders are entitled to stand in the position of judgment creditors.[2]

Debenture-holders are entitled to recover interest by way of damages, after the last interest coupon has been presented and paid by the company, if the principal be not paid at maturity.[3]

The holder of a bond issued, under the provisions of a trust deed, by a company is not a creditor of the company, either at law or in equity, within the meaning of the Companies Act of 1862, his right of action being through the trustees only.[4] But it has been held that the holder of a bond, transferred to him under the Companies Clauses Consolidation Act, 8 & 9 Vict., ch. 16, is entitled to sue upon it in his own name and behalf.[5]

A debenture-holder who has recovered judgment against the company issuing the debentures, and obtained the appointment of a receiver of the company's earnings, is not entitled to issue execution, except as a trustee for himself and the other debenture-holders, but the receiver may be directed to take proceedings for the purpose of making the judgment available for the benefit of all.[6]

[1] *In re* Herne Bay Waterworks Co. (1878), 10 Ch. D. 42.

[2] Hope *v.* Croydon & Norwood Tramways Co. (1887), 34 Ch. D. 730.

[3] Price *v.* Great Western Ry. Co. (1847), 244.

[4] *In re* Uruguay Central, etc. Ry. Co. (1879), 11 Ch. D. 372.

[5] Vertue *v.* The East Anglian Ry. Co. (1850), 19 L. J. Exch. 235.

[6] Bowen *v.* Brecon Railway Co. (1867), 3 L. R. Eq. Cases, 551.

CHAPTER XVII.

REMEDIES OF BONDHOLDERS FOR THE ENFORCEMENT OF THEIR BONDS. — ACTIONS ON THE BONDS AND COUPONS.

§ 360. **Right of Individual Bondholders to maintain an Action at Law upon their Bonds.** — (a) *General Rule.* — Since railroad bonds import an absolute promise to pay, the company is personally liable for the principal and interest thereof, and upon its failing to pay is liable to suit for the amount due.[1]

The bond is the principal debt; the mortgage an incidental security. Remedies peculiar to each exist both in law and equity; but they do not clash and destroy each other: they coexist. In an action of debt upon the obligation itself, the fact that the mortgage contains a provision whereby the trustees are empowered to sell for breach of condition upon the written request of the holders of not less than a given amount of the bonds is entirely irrelevant as a defence.[2]

Nor, it has been held, can the company defend against an action for defaulted interest upon the ground that the mortgage provides that if the coupons are not paid, the trustees, at the request of hold-

[1] Florida *v.* Anderson (1875), 91 U. S. 667.

[2] Philadelphia & Balt. Central R. Co. *v.* Johnson (1867), 54 Pa. St. 127; S. P. Montgomery Co. Agricultural Soc. *v.* Francis (1883), 103 Pa. St. 379; Welch *v.* St. Paul & Pacific R. Co. (1878), 25 Minn. 314.

ers of a certain amount of the bonds, shall enter into possession of the railroad and sell it for the benefit of the creditors; and also contains the following stipulations: "It being further expressly understood and agreed (any law or usage to the contrary notwithstanding) that neither the whole nor any part of the property . . . shall be sold under proceedings, either in law or equity, for the recovery . . . by the holder or holders of the bonds . . . of the whole or any portion of the principal or interest of the said bonds, it being the agreement and intention of the parties for the better securing the largest possible price . . . that the method of sale hereinbefore provided shall be exclusive of all others.[1]

The well-settled rule that a coupon is itself a negotiable instrument, and when detached may be sued on independently of whether the bond has been paid or not, has already been noticed (Chap. III., *ante*). See also *post*, this chapter.

The amount of a coupon so detached, with interest after demand of payment, is recoverable under a general count in debt.[2]

(b) *Right restricted by Provisions in the Bonds and Mortgage.* — A provision in the mortgage that upon the continuance of a default for six months the principal shall become due and payable, does not entitle an individual bondholder to recover the principal as well as the interest of his bonds upon the occurrence of the event referred to, where the provision is followed by one to the effect that the trustee, upon the written request of the holders of a majority of the bonds, shall proceed to collect both the principal and interest of all such bonds by foreclosure and sale. The method prescribed in the second provision for the enforcement of the debt impliedly excludes all other methods, and confines the bondholder to the remedies expressly provided.[3]

So it has been held that a bondholder cannot maintain an action on his bonds, so far as the principal is concerned, because of a provision contained in the mortgage but not in the bond, "that the principal sum secured shall become due in case the interest on the bonds remains unpaid for four months." A provision of this kind in a mortgage is not designed to give the several bond-

[1] Widener *v.* Railroad Co. (Phila. Com. Pl., 1875), 1 W. N. C. 472.

[2] National Exchange Bank *v.* Hartford, Prov. & Fitchburg R. Co. (1866), 8 R. I. 375.

In an early Connecticut case, a suit to recover the amount of an interest warrant, the court held that an interest warrant of the old style on a railroad bond did not import a promise, but was a mere acknowledgment of indebtedness for interest on the bond itself, and therefore could not be made the ground of an action. Crosby *v.* New London, Willimantic, & Palmer R. Co. (1857), 26 Conn. 121.

[3] Batchelder *v.* Council Grove Water Co. (1892), 131 N. Y. 42; s. c. 29 N. E. Rep. 801.

holders actions at law for the principal of their bonds in case of non-payment of interest, but to give the trustees a right to bring suit for the foreclosure of the mortgage, thus making the mortgage a more complete security to the bondholders.[1]

So where the bonds themselves as well as the mortgage contain conditions that the time of payment of principal and interest may be changed and postponed from time to time at the option of the majority of the bondholders, the coupons are not negotiable instruments, and a coupon-holder, being chargeable with notice of the terms of the bonds, cannot maintain an action at law upon his coupons until an extension of the time for payment of interest granted by the majority of the bondholders has expired, although he has not assented to the postponement.[2] But the conditions under which the powers of the trustees or the majority are to be exercised must be fully and exactly complied with in order to deprive a coupon-holder of his right of action against the company. Bonds which provide that a majority of the holders shall have the power to postpone the time of payment "in case of a default," do not entitle them to grant an extension of time before a default has actually occurred, so as to debar a coupon-holder who has not assented to the postponement from enforcing his claim by a suit at law.[3]

The fact that the mortgage which secures the bonds covers all the property of the corporation, and must eventually be enforced for the benefit of all the bondholders equally, although it may subject the plaintiff to the imputation of attempting to extort payment from the company, constitutes no defence to such an action. The remedy of the bondholders, if any there is, must be found in the exercise by the trustees of the power conferred upon them by the mortgage to take possession of the property covered thereby, and use its proceeds for the benefit of all the secured creditors.[4]

(c) *Right not suspended by Implication merely.* — This right of suing to judgment upon a written obligation admitted to be valid is of too high a character to be taken away by implications, especially if these are drawn from instruments other than that which

[1] Mallory *v.* West Shore & Hudson River R. Co. (1873), 35 N. Y. Sup. Ct. 174. On remedy by petition to wind up, see Portsmouth Tramways Co. (1892), 2 Ch. Div. 363.

[2] McClelland *v.* Norfolk Southern R. Co. (1888), 110 N. Y. 469; s. c. 18 N. E. Rep. 237. Manning *v.* Norfolk Southern R. Co. (see following section) was cited by counsel, but not referred to by the court.

[3] McClelland *v.* Norfolk Southern R. Co. (1888), 110 N. Y. 469; s. c. 18 N. E. Rep. 237.

[4] Ibid.

is given in direct and positive acknowledgment of the debt. The provisions of a mortgage securing the bonds control the disposition of the property which it conveys, but do not, in the absence of some explicit declaration to that effect, prevent bondholders from enforcing their claims by an action upon the bonds themselves. This right of action is not taken away by the provision commonly found in a railroad mortgage, to the effect that if interest shall remain in default for the specified period the principal may, at the option of the bondholder, become forthwith due and payable, and that the trustee shall exercise such option and declare the whole amount due upon the request of a majority in interest of the bondholders, or upon a like request waive his right to exercise the option. Nor is the right affected by a provision that the election of the trustees to pursue one or other of the alternative remedies given by the mortgage shall be subject to the power of a majority in interest of the bondholders to instruct the trustees to waive a default or to enforce their claims. Hence, although the mortgage contains provisions of this description, a bondholder who refused to assent to a funding scheme, whereby the majority of his co-bondholders agree to extend the time of payment of the coupons, may sue in assumpsit upon defaulted coupons.[1]

(d) *Right of Personal Action when Money is lent on the Credit of the Undertaking.* — Where a canal company is authorized to borrow money on the credit of the "undertaking," and it is specially provided that the creditors are to have no priority over each other, an assignment of the property and its dues to the persons lending the money, as a security for the principal and a stipulation that the interest is "to be paid half-yearly," does not give the lenders a right of action against the company itself. Their remedy is by entering on the corporate property.[2]

[1] Manning *v.* Norfolk Southern R. Co. (1887), 29 Fed. Rep. 838.

[2] Pontet *v.* Basingstoke Canal Co. (1837), 3 Bing. N. C. 433. The Canal Acts, one of which was here construed, were modelled on the theory that the proprietors were to derive the returns from their investment, chiefly through the use of the canal by the public in general. Parke, B., in Hart *v.* Eastern Union Ry. Co. (1852), 7 Exch. 246. That the creditors who had lent money on the security of an assignment such as that referred to in the text should have no personal right of action against the proprietors was a necessary deduction from this theory.

Where, however, the instrument evidencing the contract not only implies a transfer of the subject-matter till the debt is satisfied, but also includes a stipulation that the principal is to be repaid on a specified date, this imports a covenant by the company that the money shall be paid at the time appointed, and for the breach of this covenant an action lies against the company, the judgment thereon to be satisfied out of the whole property belonging to it. Hart *v.* Eastern Union Ry. Co. (1852), 7 Exch. 246; affirmed by the Exchequer Chamber, 8 Exch. 116.

§ 361. **Individual Bondholders cannot levy upon the Property mortgaged for the Security of the Whole Class.** — A bondholder when suing at law stands on the same plane as any other creditor. An execution sale of the property covered by the mortgage in pursuance of a judgment obtained in such a suit does not affect in any manner the title of the trustees, and passes only such interest as the company has in the property.[1]

As to the rights to restrain such a levy, see Chap. XV.

A bondholder may, however, subject the mortgaged property to the payment of a judgment in an action on his bonds, if he is in a position to allege that the residue of the debts secured by the mortgage have been satisfied, and brings the trustees before the court.[2]

§ 362. **Suit maintainable on Bonds though Mortgage is void.** — As already stated (Chap. II.), the invalidity of a mortgage does not render invalid the bonds secured by it. An action to recover the debt evidenced by a bond may, therefore, be maintained by the holder, although the mortgage is void.[3]

§ 363. **Coupons payable out of Revenues, no Recovery on, unless Existence of Fund shown.** — Where coupons are expressly made payable out of net revenues it is necessary, in a suit to establish the lien of the bondholders, to allege and prove the existence of

[1] Commonwealth *v.* Susquehanna & Delaware River R. Co. (1888), 122 Pa. St. 306; s. c. 15 Atl. Rep. 448; 36 Am. & Eng. R. R. Cas. 269. "The corporation in such a case," said the court, "mortgages its franchises, the gift of the State, its corporate powers and corporate property. These are not land, and the mortgage is a lien upon them only because the making of such a mortgage is expressly authorized by law. By the terms of the mortgage this personal property is conveyed to the mortgagee in trust for sale and conversion into money in a particular manner, and he is charged to apply the proceeds to the payment of the bondholders *pro rata*. . . . That the remedy of the bondholders against the property conveyed to the trustees is through him only, is fairly to be inferred from the cases. . . . When it becomes necessary for him to reach the property, he must proceed against the trustee, not for his own separate benefit, but as a bondholder, and on behalf of the bondholders as a class."

The English Companies Clauses Act provides expressly that debenture-holders shall be paid without any respect to priority in the date of their debentures, and this provision has been held to be inconsistent with a right of any individual debenture-holder to have execution of a judgment for his debt otherwise than as a trustee for all the debenture-holders. Bower *v.* Breen Ry. Co. (1867), L. R. 3 Eq. 540. See also Brinsley *v.* Lynton Hotel Co. (1895), 13 Rep. 371.

[2] Martin & Merriwether *v.* Mobile & Ohio R. Co. (1870), 7 Bush (Ky.), 116.

[3] Shaver *v.* Bear River & Auburn Water & Mining Co. (1858), 10 Cal. 396.

Upon much the same principle a *bona fide* creditor is not precluded from participating in the assets of an insolvent corporation, for the reason that he has taken a mortgage to secure his debt; and this is declared invalid as an illegal preference of a creditor. Thompson *v.* Huron Lumber Co. (1891), 4 Wash. 600; s. c. 30 Pac. Rep. 741; 31 Pac. Rep. 25.

the fund; and when there are no such revenues on hand, a demand of payment is properly refused.[1]

§ 364. **In whose Name an Action on a Bond may be brought.** — Wherever bonds are conceded to be negotiable instruments, or in the nature of negotiable instruments (see Chap. II., *ante*), the holder may, of course, sue on them in his own name; but in Pennsylvania a distinction has been taken between a bond payable "to bearer" and one payable "to A. or his assigns." A bond in the latter form cannot be sued on in the name of the assignee unless the provisions of the statute of 1715 are complied with, which allow a suit by such assignee only when the assignment has been made under hand and seal before two or more credible witnesses.[2]

§ 365. **Demand of Payment, how far necessary before bringing Suit on a Bond or Coupon.** — As to whether the obligor is in default on a bond or coupon payable at a particular place, where no demand of payment has been made, the authorities are in conflict.[3] In Pennsylvania it is held that coupons payable at a particular place import that the debtor will have a deposit at the time and place specified to answer what is substantially a draft on the funds of the debtor. Without showing that such a fund was provided, it is no defence to an action on coupons to allege a want of demand.[4]

On the other hand, the rule in South Carolina is that an action may be maintained on a bond payable on a day certain at a place named, without allegations or proof of demand of payment at the time and place mentioned.[5]

Where a railroad company issues bonds payable at its office in a particular way, and at the maturity of the bonds there is no office at that place, a demand for payment elsewhere is sufficient.[6]

§ 366. **Suits on Lost Coupons.** — The right to sue on a lost coupon is subject to the same limitation as the right to sue on any lost negotiable instrument, — that is to say, the plaintiff must tender indemnity as a condition of being allowed to bring the action.[7]

[1] Corcoran *v.* Chesapeake & Ohio Canal Co. (1874), 1 MacArthur, 358 (1874).

As to the liability of the trustees of the Internal Improvement Fund of the State of Florida to pay out of that fund the interest on the railroad bonds guarantied by the State, see Hawkins *v.* Mitchell (1895), 34 Fla. 405; s. c. 16 So. Rep. 311.

[2] Bunting's Admrs. *v.* Camden & Atlantic R. Co. (1876), 81 Pa. St. 254; s. c. 15 Am. Ry. Rep. 570.

[3] See as to commercial paper generally, Dan. on Neg. Instr., § 1514.

[4] Philadelphia & Balt. Central R. Co. *v.* Johnson (1867), 54 Pa. St. 127; Northern Pennsylvania R. Co. *v.* Adams (1867), 54 Pa. St. 94.

[5] Langston *v.* South Carolina R. Co. (1870), 2 S. C. (U. S.) 248.

[6] Alexander *v.* Atlantic, Tennessee, & Ohio R. Co. (1872), 67 N. C. 198.

[7] Fitchett *v.* Northern Pennsylvania R. Co. (1863), 5 Phil. 133.

CHAPTER XVIII.

REMEDIES OF BONDHOLDERS. — SUITS FOR POSSESSION.

§ 367. **Generally.**[1] — If the mortgage simply stipulates that, upon default in the payment of interest, the trustee may take possession, he may take possession without bringing an action to foreclose, and, if he be prevented from taking possession, may have an action to be put in possession.[2]

But after a receiver has been appointed for an entire system of railroads, the right of the trustee of a divisional mortgage upon which default has been made is not absolute. At one stage of the Wabash litigation [3] several divisional trustees were placed in control of the properties covered by their respective mortgages, but a subsequent application by the trustee of another of these mortgages to be put in possession was refused. The court, in its discussion of the inexpediency of further disintegrating the system, considered the rights and expectations of the stockholders and all the various classes of bondholders. It was pointed out that the general mortgage bondholders did not purchase their bonds with the simple expectation that they would be paid out of merely the residuum left after paying the divisional mortgages,

[1] As to questions of conflicting jurisdiction in suits for possession, see Chap. XXI., on jurisdiction.

[2] Seibert v. Minneapolis & St. Louis R. Co. (1893), 52 Minn. 246; s. c. 53 N. W. Rep. 1151.

[3] See Central Trust Co. v. Wabash, St. L. & Pac. Ry. Co. (1885), 23 Fed. Rep. 693.

but that there was a grand system to be worked as a unit, and that this would make a greater and better security for their bonds. As there was a movement to keep it together, and have a decree for the sale of the entire property by agreement between the representatives of the majority of the bondholders, the petition was declined until the development of events showed whether this scheme would be carried out or not.

Default in the principal is not necessary to enable the trustees to maintain a suit for possession, where the mortgage expressly gives the right to enter, either upon the failure of the company to pay any of the overdue coupons, or to pay the principal of the bonds.[1]

The right of the trustee to take possession and control of the property, and carry on the business for which it is used, is a property right or interest which survives the voluntary dissolution of the corporation.[2]

§ 368. **The Trustee's Right of Entry must be exercised in Strict Accordance with the Provisions of the Mortgage which confer the Right.** — If they are permitted to take possession after six months' default in interest, "on being requested to do so by the holders of at least $100,000 of bonds," a request from such bondholders is a condition to any action on the part of the trustees.[3]

A provision that, "in case default shall be made in the payment of interest, etc., and such default shall continue six months after the same has been demanded, the whole principal sum shall, at the option of a majority in interest of the bonds, become forthwith due and payable; and in *such case* it shall be lawful for the trustee to enter upon the property," etc., must be construed as meaning that this extraordinary power can be exercised only when there has been both a default in the interest and also a declaration of the bondholders that the principal has become due. Especially should this meaning be attributed to the provision when another section of the deed contains directions as to the powers and duties of the trustee in regard to foreclosure for a default in interest.[4]

So also, where the mortgage gives the right of entry after a month's default in interest, the court will not read into the instrument a provision requiring the interest to be paid out of profits, and on this theory enforce specific performance of the contract,

[1] Macon & Anniston R. Co. *v.* Georgia Railroad & Bkg. Co. (1879), 63 Ga. 103; s. c. 1 Am. & Eng. R. R. Cas. 378.

[2] Nelson *v.* Hubbard (1892), 96 Ala. 238; s. c. 11 So. Rep. 428; 12 Ry. & Corp. L. J. 182.

[3] Southern Pacific R. Co. *v.* Doyle (1882), 11 Fed. Rep. 253, 266.

[4] Union Trust Co. *v.* Missouri, Kans. & Tex. Ry. Co. (1881), 26 Fed. Rep. 485.

when the interest has been actually paid, but out of insurance money received upon the destruction of the corporate plant.[1]

§ 369. **The Right of a Trustee to bring Suit for Possession is sometimes implied.** — Where the mortgage provides that the company, as long as it is not in default as to the interest or principal of its bonds, may retain possession, the right of a trustee to bring suit for possession is implied. Such a provision embraces the converse proposition, that, if the company does make default, it is not entitled to retain possession.[2]

§ 370. **When a Business is "unprofitable" so as to entitle Trustee to take Possession.** — The business of a corporation is not "unprofitable," within the meaning of a provision in a trust deed, that, if the business is not profitable, the trustee may, upon request of the bondholders, take possession of the property where, after making allowances for differences in inventory prices and for extraordinary expenses in refunding its indebtedness, profit is shown, although its books, by reason of failure to make such allowances, show a loss.[3]

§ 371. **Trustees of First Mortgage cannot be ousted from Possession by Junior Mortgagees.** — Bondholders under a second mortgage have no right to bring action for possession against the trustees of a first mortgage in possession or one holding under them. Their rights are subordinate to the first mortgage, and they have merely a right to redeem.[4]

§ 372. **Special Powers conferred on Trustee not available to Bondholder suing on his own Behalf.**[5] — If a beneficiary of the trust deed comes into court in his own name, upon the refusal of the trustee to act, he is restricted to the remedies furnished by the procedure of the court appropriate to the end desired. He may, as shown in the succeeding chapter, foreclose for default in interest, but he is not entitled to have the court exercise the powers of sequestration and sale conferred on the trustee in case of such default.[6]

§ 373. **Equitable Jurisdiction of Suits for Possession.** — An action of ejectment may be maintained by the trustee immediately after default wherever the common-law rule as to the rights of a mortgagee, after condition broken, still prevails; but not where the

[1] Michigan Trust Co. *v.* Lansing Lumber Co. (1895), 103 Mich. 392; s. c. 61 N. W. Rep. 668.

[2] Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 260, 265.

[3] Michigan Trust Co. *v.* Lansing Lumber Co. (1895), 103 Mich. 392; s. c. 61 N. W. Rep. 668.

[4] Webb *v.* Vermont Central R. Co. (1881), 9 Fed. Rep. 793.

[5] For the special powers of the trustee, consult Chap. XI.

[6] McFadden *v.* Mays Landing & Egg Harbor City R. Co. (1891), 49 N. J. Eq. 176; s. c. 22 Atl. Rep. 930.

doctrine that a mortgage is simply a lien has been adopted, for the legal title is then in the mortgagor.[1] The effect of the usual provisions in trust mortgages, that the trustees may take possession after default, is to invest him, by the express stipulation of the parties, with the same right that a mortgagee possessed under the rule of the common law.

The view has been taken that the trustee has an adequate remedy for the enforcement of this right by an action of ejectment for the real estate, and action of claim and delivery for the personalty.[2] But the better opinion is that the remedy at law is not adequate in the case of a railroad mortgage. The forms and processes of law are not flexible enough to transfer as an entirety mortgaged property of such a complicated character, embracing, as it does, real, personal, and mixed, and a separation of these several kinds of property would be repugnant to the presumed intentions of the parties in entering into the contract.[3]

"The nature of the property with the possession of which they [the trustees] seek to be invested renders it impossible to find a remedy in a single suit at law. Unless resort be had to equity, there must be a multiplicity of actions if the property extends over more than one county, and resistance is made to their claim of possession, besides such other proceedings as may be necessary to obtain control of the franchise of the corporation. In addition to this, the trust is to be regulated after possession is taken. To control all this property, to enforce all these obligations, and to preserve the rights of all the parties interested, it is only when exercising equitable powers that a court can afford a complete remedy."[4] Such a suit may be regarded as one for the specific performance of the contract,[5] or as an application to the court to exercise its general powers for the administration of the trust.[6]

[1] Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 260, 265; s. c. 17 Am. & Eng. R. R. Cas. 324, decided with reference to the law of Arkansas.

[2] Rice *v.* St. Paul & Pacific R. Co. (1878), 24 Minn. 464.

[3] Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 260, 265; s. c. 17 Am. & Eng. R. R. Cas. 324, where the court thought it beyond question that an action of claim and delivery for non-delivery of property could not be an adequate remedy against a mortgagor which was insolvent. This ruling is in direct antagonism to the Minnesota case cited.

[4] Shaw *v.* Norfolk County R. Co. (1855), 5 Gray, 162.

[5] McLane *v.* Placerville & Sacramento Valley R. Co. (1885), 66 Cal. 606; s. c. 26 Am. & Eng. R. R. Cas. 404; Shepley *v.* Atlantic & St. Lawrence River R. Co. (1868), 55 Me. 395; Sacramento & Placerville R. Co. *v.* Superior Court (1880), 55 Cal. 453; Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 260, 265; s. c. 17 Am. & Eng. R. R. Cas. 324.

[6] Shaw *v.* Norfolk County R. Co. (1855), 5 Gray (Mass.), 162. In that case the court, in considering the question of the propriety of a suit in equity, observed

§ 374. **Possession by the Corporation under Scrutiny of Court and Parties to the Suit.** — In the case of Chesapeake & Ohio Canal Co. the mortgage provided that the corporation should retain possession of the canal so long as it should comply with the agreements in the mortgage; and if it should fail to comply with these agreements from any cause, except a deficiency of revenue arising from a failure of business, without fault on its part, the default to be made to appear by the trustees, — then the trustees might demand, and should receive, possession, and should appropriate the tolls and revenues. On a bill for the appointment of a receiver, the court failed to find from the evidence that the bondholders were not paid because of mismanagement. The State of Maryland, as the owner of a majority of valueless stock of the corporation, appointed the managers. But it appeared to the court equitable that the bondholders should be afforded some convenient method of scrutinizing the receipts and expenditures of the canal company. The court retained the bill, and decreed that the company file with the court quarterly reports for the information and protection of the bondholders. The court dealt with the corporation as a *trustee*.[1] This case does not conflict with that class of cases which hold that the mortgagor has uncontrolled powers of earnings while not in default, but it gives a right of inspection and scrutiny of accounts of a company to bondholders.

Analogous to this is the effect of the commencement of a suit for possession. In such case, from the time of the bringing of the suit the company itself is to be treated in all respects as a receiver of the property, holding for the benefit of whomsoever in the end it should be found to concern, and liable to account accordingly.[2] In this last case, pending the appointment of a receiver the defendant was ordered to hold the property subject to the order of the court.

§ 375. **What Law governs in Suits for Possession.** — The law of the State where the railroad is situated furnishes the rule for determining the rights of the mortgagees under the mortgage, unless that rule can be and has been changed by the contract of the parties.[3]

that, on the discharge of the duties imposed upon the trustees by the contract, "the possession, management, and control of the estates and interests conveyed to them may become indispensable, and presumably do become so, when the circumstances arise which entitle them to possession. For the due enforcement of such a trust ample power is found in a court of equity, and a bill for possession is an appropriate course of proceeding to procure for that purpose the intervention and exercise of its authority."

[1] Stewart *v.* Chesapeake & Ohio Canal Co. (1881), 5 Fed. Rep. 149, 157.

[2] Dow *v.* Memphis R. Co. (1887), 124 U. S. 655.

[3] Dow *v.* Memphis R. Co. (1884), 20 Fed. Rep. 260; Southern Pacific R. Co. *v.* Doyle (1882), 11 Fed. Rep. 253.

CHAPTER XIX.

FORECLOSURE AND SALE.

ARTICLE I. — IN GENERAL.

§ 376. **Right to foreclose on Default in Payment of Interest inherent to the Mortgage Contract.** — In the absence of any specific provision to the contrary in the mortgage, the right to foreclose accrues as soon as the interest is in default, although the principal may be only payable at the end of a fixed period.[1]

The foundation of this rule is that the interest is not a mere incident of the debt, but a part of the debt itself, and therefore no less secured by the property subject to the lien than is the principal itself. The rights of the parties are accordingly determined by the principle that whenever a debt is payable in instalments, a mortgage securing that debt may be foreclosed whenever one of the instalments is in default.[2]

It is usual for railroad mortgages to contain express provisions to the effect that the lien is created to secure the payment of the interest as well as the principal of the bonds, and that a default in the payment of the interest alone will entitle the beneficiaries to have the lien enforced by certain specified proceedings. But the right to set the law in motion for the enforcement of the lien by a foreclosure suit exists apart from any such stipulation as to the employment of certain remedies, — a doctrine thus clearly and emphatically laid down by the Supreme Court of the United

[1] Edwards *v.* Martin, 25 L. J. Ch. N. S. 284, following a *dictum* of Sir Edward Sugden in Barrowes *v.* Molloy, 2 Jones & Lat. 521.

[2] West Branch Bank *v.* Chester (1849), 11 Pa. St. 282, citing Gladwin *v.* Hitchman, 2 Vern. 135. See also Goodman *et al.* Trustees, etc. *v.* Cincinnati & Chicago R. Co. (1858), 2 Disn. (Ohio), 176, where the court remarked that the interest "may grow out of and be dependent on the principal debt, yet, when once due, it must draw after it the benefit of the security given for its payment; not by its ultimate discharge when the principal shall become due, but its prompt and certain liquidation at the several times at which it was agreed to be paid." To the same effect see Farmers' Loan & Trust Co. *v.* Oregon & C. Ry. Co. (1885), 24 Fed. Rep. 407; Cleveland *v.* Booth (1890), 43 Minn. 16; s. c. 44 N. W. Rep. 670; Penna. Co. for Ins. on Lives and Granting Annuities *v.* Philadelphia & Reading R. Co. (1895), 69 Fed. Rep. 482.

In Swasey *v.* North Carolina R. Co. (1874), 1 Hughes, 17; s. c. reported in 71 N. C. 571, corporate stock had been pledged for the "redemption" of certain "certificates of debt," and the certificates bound the debtor for the payment of the "sum therein mentioned and other interest thereon." *Held*, that the stock was bound for the payment of the interest itself, and that a foreclosure might be decreed on default of any instalment thereof.

A debenture in the usual English form, charging all the property of the company, both present and future, including its uncalled capital, confers upon the holder, in the event of the debenture becoming immediately payable in consequence of a winding up, the ordinary mortgagee's remedy by foreclosure against the uncalled capital, as well as the other property comprised in the security. Sadler *v.* Worley (1894), L. R. 2 Ch. 170.

States: "Inasmuch as by the terms of the first article (of the mortgage) the conveyance is declared to be for the purpose of securing the payment of the interest as well as the principal of the bonds, and by the fourth article the mortgagor's right of possession terminates upon a default in the payment of interest as well as principal on any of the bonds, we are of opinion that, independently of the provisions of the other articles, the trustees, or, on their failure to do so, any bondholder, on the non-payment of any instalment of interest on any bond, might file a bill for the enforcement of the security by the foreclosure of the mortgage and sale of the mortgaged property. This right belongs to each bondholder separately, and its exercise is not dependent upon the co-operation or consent of any others, or of the trustees. It is properly and strictly enforceable in the name of the latter, but if necessary may be prosecuted without, or even against, them. It follows from the nature of the security, and arises upon its face, unless restrained by its terms."[1]

A practical consideration which militates strongly against a different construction of the mortgage contract is, that, if resort could not be had to foreclosure and sale of the property for default in the payment of interest, the company would be enabled to hold the money of its bondholders for a long period of years, and that if the bondholders' remedy were thus suspended (possibly for the lifetime of a generation), no company could be so bold as to ask, nor any capitalist so foolish as to grant, a loan for railroad purposes.[2]

An agreement of certain bondholders of a railroad company operating its road at a loss, and owing a large floating indebtedness, with a lessee of the road, unknown to the company or the trustee of the mortgage securing the bonds, that they would not seek to enforce the payment of interest on the bonds for ten years, which further has been soon repudiated by some of the parties to it, cannot be interposed by a bondholder to prevent a foreclosure of the mortgage for default in payment of the interest in an action brought by the trustee.[3]

[1] Chicago, Danville, & Vincennes R. Co. *v.* Fosdick (1882), 106 U. S. 47. See article on "Foreclosure of Railroad Mortgages," by Lisle, 20 Am. L. Rev. 867. See note on request that trustee foreclose mortgage, by Adelbert Hamilton, 23 Am. L. Reg. N. S. 49. See as to foreclosure by bondholder, Stern *v.* Wisconsin Cent. R. Co. *et al.* (1879), 8 Rep. 488; s. c. 22 Fed. Cas. 1310, Case No. 13,378. See as to foreclosure of mortgage by subsequent incumbrancer, Sutherland *et al.* *v.* Lake Superior Ship Canal, Railroad, & Iron Co. *et al.* (1874), 9 N. B. R. 298; s. c. 1 Cent. L. J. 127; 23 Fed. Cas. 459, Case No. 13,643.

[2] Wilmer *v.* Atlanta & Richmond Air Line Ry. Co. (1875), 2 Woods, 447.

[3] Farmers' Loan & Trust Co. *v.* Rockaway Valley R. Co. *et al.* (1895), 69 Fed. Rep. 9.

The right to foreclose for interest being inherent in the contract, the mere omission to insert a provision in the mortgage that the principal is to become due upon a default in the payment of interest will not prevent a resort to this remedy.[1]

For the same reason a resolution of the board of directors directing an issue of bonds and a mortgage to secure them, payable in twenty-five years, with semi-annual payments of interest, authorizes the insertion of a provision that, "in case of default in the payment of interest, the whole principal and interest shall be due." These words, it was declared, were necessary to render the bonds marketable, and added nothing which the law itself would not grant.[2]

§ 377. **Provisions which negative the Right of the Trustees to treat a Corporate Trust Deed as a Mortgage and foreclose it.** — These are occasionally found in such instruments. This construction has been placed on a deed securing bonds issued to raise money to discharge existing liens on tracts of unimproved land, and render them available for sale, where it was apparent from the general term of the instrument that the essence of the plan contemplated when the bonds were issued was the general discharge of the debt as the land was improved and sold off for building lots, and that the plan was to remain the same whether the companies or the trustees carried it out. Special stress was laid by the court on the points that the deed fixed no limit to the mortgagor's right to redeem; that the trustees, upon entry for default, were to manage and dispose of the property "as agents of the mortgagor," — a provision evidently referring to a possession of a different character from that stipulated for in ordinary mortgages; and that the trustees, after applying surplus proceeds of sales to the payment of the bonds, were to restore the residue and all the property remaining in their possession to the mortgagor.[3]

§ 378. **Mortgagee not required to resort to Sinking Fund for Payment, when.** — The fact that the act authorizing a corporation to issue bonds also provides for a sinking fund for their redemption to be created out of the rents of certain buildings which it is proposed to erect on the land covered by the mortgage securing the bonds, does not preclude a bondholder from foreclosing the mortgage when the bonds fall due.[4]

[1] Bardstown & Louisville R. Co. *v.* Metcalfe (1862), 4 Metc. (Ky.) 199.

[2] Coe *v.* New Jersey Midland Ry. Co. (1879), 31 N. J. Eq. 105.

[3] Shepard *v.* Richardson (1887), 145 Mass. 32; s. c. 11 N. E. Rep. 738.

[4] Commonwealth *v.* Louisville Trust Co. (1894), 26 S. W. Rep. 582, not officially reported.

§ 379. **Improper Motives of Complainant no Ground for denying Relief.** — That the plaintiff is actuated by personal or improper motives in bringing a foreclosure suit is, as a general rule, no ground for denying him the relief he is legally entitled to. The sale will not be delayed merely because it appears that he is acting in the interest of a rival company, and that his object is to bring the mortgaged property to a speedy sale upon a depressed market, and thus enable that company to acquire it at a low price,[1] nor because the object of the bondholders seeking foreclosure is to obtain ultimate control of the property.[2]

But an important exception to this rule exists where the holders of the bonds who are pressing for foreclosure are also holders of a majority of the stock of the mortgagor company, and the proceedings are for the purpose of obtaining an undue advantage over the minority stockholders. It is therefore a good defence to an action for foreclosure that the bonds held by the plaintiff's *cestuis que trust* were acquired by them, together with a majority of the mortgagor company's stock, in pursuance of a scheme to throw the company into insolvency by misusing the power to control its affairs, which they obtained by their purchase of the stock, and then enforced the mortgage lien under circumstances which will enable them to purchase the property at less than its market value. Such conduct is inconsistent with the duty which majority stockholders owe to the minority.[3]

§ 380. **Right of Prior Mortgagee of Part of Property to foreclose pending Suit to foreclose Mortgage on Entire Property.** — The consolidation of the mortgagor company with another, and the execution of mortgages by the consolidated company, one covering its entire property, and the other the property not embraced in the first mortgage, does not affect the right of a bondholder secured by the first mortgage to enforce his security as respects that part which it embraces. He cannot be delayed in the foreclosure of his mortgage and compelled to abide the sale of the entire property in a suit instituted by the trustee of one of the subsequent mortgages. The mere fact that some of the principal bondholders secured by the first mortgage have interests antagonistic to the portion of the property belonging to the consolidated company which is not embraced in that mortgage does not con-

[1] Toler *v.* East Tennessee, V. & G. Ry. Co. (1894), 67 Fed. Rep. 168.

[2] Farmers' Loan & Trust Co. *v.* Green Bay & Minnesota R. Co. (1881), 6 Fed. Rep. 100, 110. Compare County of Leavenworth *v.* Chicago, R. I. & P. R. Co. (1885), 25 Fed. Rep. 219, 229.

[3] Farmers' Loan & Trust Co. *v.* New York & Northern Ry. Co. (N. Y. Ct. of App., 1896), 44 N. E. Rep. 1043.

stitute any equitable reason for refusing to allow the mortgage to be foreclosed.[1]

§ 381. **Matters which will not be considered in Foreclosure Suits.** — A claim of title paramount to that of the mortgagor cannot be tried in a foreclosure suit, unless the jurisdiction of the courts is aided in this respect by some statutory provision.[2]

The Code of Washington (§§ 143, 150) has not changed the rule that a claim of prior and paramount adverse title cannot be litigated in a foreclosure suit.[3]

The question of the fairness and equity of reorganization plans will not be considered upon an application by stockholders of a railroad company to interpose a defence to foreclosure of a mortgage, since any person is entitled to purchase at a foreclosure sale, and if the stockholders believe the property mortgaged exceeds in value the debts upon it, they may purchase it themselves.[4]

A judgment creditor of a mortgagor corporation cannot, in a suit to foreclose the mortgage, assert that there was no resolution of the stockholders for its issuance, or that it was not recorded.[5]

§ 382. **The Right to file a Bill of Foreclosure in an Original Proceeding ceases when the Corporation is dissolved.** — The claims evidenced by the trust deed and the bonds can be asserted only in the dissolution proceeding, after it has been instituted; and if an original bill is filed by the trustee in the court where that proceeding is pending, it should be treated on the footing of a claim presented therein, and dealt with accordingly.[6]

Article II. — Remedy of Foreclosure cumulative upon Special Remedies provided by the Mortgage.

§ 383. **General Rule.** — It is well settled that the special powers conferred upon the trustees by the provisions of an ordinary railroad mortgage, for the purpose of enabling them to enforce the security, in case of a default in the payment of principal or interest, are merely cumulative to the remedy by means of foreclosure.[7]

[1] Olyphant *v.* St. Louis Ore & Steel Co. (1885), 23 Fed. Rep. 465.

[2] It is believed that the Practice Act of Connecticut admits of the trial of such a claim. See DeWolf *v.* A. & W. Sprague Manufacturing Co. (1881), 49 Conn. 282; Farmers' Loan & Trust Co. *v.* San Diego Street Car Co. (1889), 40 Fed. Rep. 105.

[3] California Safe Deposit & Trust Co. *v.* Cheney Electric Light, Tel. & Power Co. (1895), 12 Wash. 138; s. c. 40 Pac. Rep. 732.

[4] Farmers' Loan & Trust Co. *v.* Toledo, A. A. & N. M. R. Co. (1895), 67 Fed. Rep. 49.

[5] Farmers' Loan & Trust Co. *v.* Chicago & N. P. R. Co. (1895), 68 Fed. Rep. 412.

[6] Nelson *v.* Hubbard (1892), 96 Ala. 238; s. c. 11 So. Rep. 428; 12 Ry. & Corp. L. J. 182.

[7] McFadden *v.* May's Landing and Egg Harbor City R. Co. (1891), 49 N. J. Eq. 176; s. c. 22 Atl. Rep. 932 (citing a large number of cases); McAllister *v.* Plant

Especially should the remedy by entry and sale be regarded as cumulative when the laws of the State in which the railroad is situated forbid sales under a power in a trust deed by proceedings out of court. The remedy in this case would be of no value.[1]

In the case of the trustees there is an additional reason why the mere fact that they are invested with these special powers should not preclude them from a resort to ordinary equitable remedies. They are holders of the legal estate in the mortgage for the benefit of the bondholders, and a trustee can always come into a court of equity for aid or instruction in conserving his trust.[2]

Sometimes the mortgage itself recognizes by its terms the principle illustrated in the cases already cited in this section by an express declaration to the effect that the remedies of entry and sale conferred by it are "cumulative to the ordinary remedies by foreclosure,"[3] or provides that nothing therein shall be held or construed to prevent or interfere with the foreclosure of the instrument by any court of competent jurisdiction.[4]

(1876), 54 Miss. 106; s. c. 17 Am. Ry. Rep. 389; Central Trust Co. *v.* New York City & Northern R. Co. (1884), 33 Hun, 513; Alexander *v.* Central Railroad of Iowa (1874), 3 Dill. 487; First Nat. Fire Ins. Co. *v.* Salisbury (1881), 130 Mass. 303; 4 Am. & Eng. R. R. Cas. 480; Williamson *v.* New Albany, etc. R. Co. (1857), 1 Biss. 198.

The mortgagees of a section of a Canadian railway in the hands of a receiver, appointed in a judgment creditor's action, were held entitled to proceed in equity for a sale of the property immediately upon default, regardless of a clause in the mortgage providing for a sale after the lapse of a certain time. Allan *v.* The Manitoba & Northwestern Ry. Co. (1894), 10 Man. Rep. 106.

[1] Alexander *v.* Central Railroad of Iowa (1874), 3 Dill. 487.

[2] Phinizy *v.* Augusta & K. R. Co. (1893), 56 Fed. Rep. 273.

[3] See, for example, the mortgage under review in Mercantile Trust Co. *v.* Missouri, K. & T. R. Co. (1888), 36 Fed. Rep. 221; s. c. 36 Am. & Eng. R. R. Cas. 259.

[4] Morgan's Louisiana & Texas R. & Steamship Co. *v.* Texas Central Ry. Co. (1890), 137 U. S. 171; s. c. 11 Sup. Ct. Rep. 61; 45 Am. & Eng. R. R. Cas. 63. The probable motives of the parties in inserting such a clause, evidently out of abundant caution, inasmuch as it merely embodied the general rule on the subject, were thus explained by Chief Justice Fuller: "It is easy to see why taking possession and selling without the intervention of the court should be guarded against, and the trustee not be required or allowed to proceed in that summary manner except on the request of a certain percentage of the holders of the bonds. Such proceedings might result in injury, which could not be predicted of those regularly taken in a court of equity. Arbitrary procedure by the trustee was not deemed desirable in view of the interests of both mortgagor and the bondholders as a class, while each would find the protection to which it might be entitled at the hands of the court." A provision to the effect that neither the whole nor any part of the premises mortgaged shall be sold, under proceedings either at law or equity, for the recovery of the principal or interest of the bonds, it being the intention of the parties that the mode of sale provided by the mortgage shall be exclusive of all others, is not enforceable, as it is an attempt to provide against a remedy in the ordinary course of judicial proceedings, and oust the jurisdiction of the courts.

§ 384. **Application of Rule to Cases where a Trustee is precluded from taking Possession until the Default has continued a Specified Period.** — Agreeably to the principle stated above, it has been uniformly held by the courts that the various provisions by which the action of the trustees is regulated in the exercise of those powers will not, in the absence of an express stipulation to that effect, be construed as applicable to this concurrent remedy.[1]

Thus where it is stipulated that "until default shall be made in the payment of interest for six months, after written demand for payment by the trustee, the mortgagor shall remain in possession, and control the property," but that "after such default the trustee may take possession," it is only the right to take possession that is limited, and the trustee may foreclose immediately upon default.[2]

Similarly a provision authorizing entry and sale by the trustee upon the expiration of twelve months after the default of the company in paying the principal and interest, does not prevent the trustee from bringing an action to foreclose immediately upon default in the payment of interest.[3]

Nor is the trustee precluded from foreclosing before the default thus continued six months, although the mortgage provides that "until default the mortgagor shall be permitted to remain in possession," and that "in case of default in the payment of interest for six months it shall be the duty of the trustee to take steps to enforce the rights of the bondholders."[4]

Nor, it seems, is the right of the trustee to foreclose immediately upon default in the payment of interest affected by the fact that the mortgage provides that, in case the mortgagors "fail to pay the interest on any of the said bonds at any time when the same may become due and payable according to the terms thereof, and shall continue in default for six months after such payment has been demanded, . . . then and thereupon the principal of all the bonds hereby secured shall become immediately due and payable, provided, etc., and that in such case . . . the trustee . . . may take, with or without entry and foreclosure, actual possession of said road," and there is no express provision in the deed for immediate

[1] See generally on this subject an article in 16 Centr. L. J. 247.

[2] Farmers' Loan & Trust Co. *v.* Winona & St. L. R. Co. (1893), 59 Fed. Rep. 957.

[3] Central Trust Co. *v.* New York City & Northern R. Co. (1884), 33 Hun, 513; compare McLane *v.* Placerville & Sacramento Valley R. Co. (1885), 66 Cal. 606; 26 Am. & Eng. R. R. Cas. 404.

[4] Mercantile Trust Co. *v.* Chicago, P. & St. L. R. Co. (1893), 61 Fed. Rep. 372. Compare Farmers' Loan & Trust Co. *v.* Nova Scotia Ry. Co. (1894), 24 Nov. Scot. 542, where the law of the Province made the whole principal due upon default, and it was held that a provision such as that in the text was no obstacle to an immediate foreclosure.

foreclosure upon such default. Such a provision merely relates to the manner in which the principal shall be made due.[1]

§ 385. **Application of Rule to Cases where a Request from Bondholders is a Prerequisite to Entry by Trustees.** — The right of foreclosure for interest, whether by the trustee acting in behalf of one or more bondholders acting in behalf of the whole class, is not affected by a provision that the trustee cannot, without the request of a certain percentage of bondholders, take possession of the road,[2] or declare the principal due, and foreclose thereon;[3] nor by a provision that until default the mortgagor shall remain in possession, and that, on default of the principal and interest on any bond, and on request of the holders of one-half in amount of the bonds, the trustee shall sell the property and apply the proceeds to the payment of the bonds.[4]

The same conclusion has been reached where a trust deed hypothecating stock provided that after the continuance of a default for six months the trustee might, and upon the demand of a majority in amount of the bondholders should, declare the principal due, and that in either of such cases might, and upon request of a like majority should, proceed to sell the shares, and also reserved to the majority the right to revoke the declaration of the maturity of the principal and put a stop to the proceedings. In spite of the powers thus conferred on the majority, the trustee may, at the instance of the minority, foreclose the trust deed in their behalf.[5]

Article III. — When the Default is complete for Purposes of Suit.

§ 386. **Generally.** — "Default" means "something wrongful, some omission to do that which ought to have been done by one

[1] Central Trust Co. *v.* Texas & St. Louis R. Co. (1885), 23 Fed. Rep. 846.

[2] Phinizy *v.* Augusta & K. R. Co. (1893), 56 Fed. Rep. 273; Farmers' Loan & Trust Co. *v.* Chicago, etc. R. Co., 27 Fed. Rep. 152; S. P. Alexander *v.* Central Railroad of Iowa (1874), 3 Dill. 487; Central Trust Co. *v.* Texas & St. L. R. Co. (1885), 23 Fed. Rep. 846; Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 260; Eaton & Hamilton R. Co. *v.* Hunt (1863), 20 Ind. 457; Penn. Co. for Ins. of Lives and Granting Annuities *v.* Philadelphia & Reading R. Co. (C. C. E. D. Pa.), 36 W. N. C. 534; Williamson *v.* New Albany, etc. R. Co. (1857), 1 Biss. 198; Guaranty Trust & Safe Deposit Co. *v.* Green Cove Springs & M. R. Co. (1890), 139 U. S. 137; s. c. 11 Sup. Ct. Rep. 512; 45 Am. & Eng. R. R. Cas. 689; Credit Co. *v.* Arkansas Central R. Co. (1882), 15 Fed. Rep. 46; Mercantile Trust Co. *v.* Missouri, K. & T. R. Co. (1888), 36 Fed. Rep. 221.

[3] Farmers' Loan & Trust Co. *v.* Chicago & A. R. Co. (1886), 27 Fed. Rep. 146, 152.

[4] First National Fire Ins. Co. *v.* Salisbury (1881), 130 Mass. 303; s. c. 4 Am. & Eng. R. R. Cas. 480.

[5] Toler *v.* East Tennessee, V. & G. R. Co. (1894), 67 Fed. Rep. 168.

of the parties, and this cannot be the case when the omission to make payment has the concurrence of the other party." Hence, if the mortgagee assents to a request made by the mortgagor that the payment of an instalment of interest shall stand over till a certain day, there can be no such "default" as will justify the foreclosure of the mortgage on that ground until the stipulated day arrives, or, supposing the promise of the mortgagee to have been made without consideration, until he revokes the license to extend the time, and makes a fresh demand for payment of the instalment.[1]

§ 387. **Right to foreclose, how far affected by Special Agreements.** — The right to foreclose for interest may be suspended by an absolute covenant on the part of the mortgagee that the principal shall not be called in during a specified period, or until the happening of a certain event.[2]

But a mere agreement on the part of the bondholders to consent to the company's paying only half interest for an indefinite time, understood not to exceed a certain period, cannot be construed as binding the bondholders to wait until the end of that period before instituting proceedings to enforce their lien. The only restriction which such an agreement puts upon their action is that they cannot terminate the plan thus entered upon without reasonable or fair notice to the company.[3]

Nor do the bondholders forego their right to sell the road for default in payment in interest merely by entering into a contract whereby a person, in consideration of his advancing sufficient money to pay the floating debts, is given a lien on the road for the amount prior to that of the mortgage, and invested with the control and management of the property for a period of three years. Such a contract raises no implication of a promise by the bondholders to extend the time for payment of interest, and leaves the rights and obligations existing between them and the company precisely what they were before it was executed.[4]

§ 388. **Words of Bonds controlling as to whether Default has occurred.** — The bonds being the principal thing, containing the

[1] Albert *v.* Grosvenor Investment Co. (1867), L. R. 3 Q. B. 123.

[2] Burrowes *v.* Molloy, 2 Jones & Lef. 521, per Sugden, L. C.

[3] Union Trust Co. *v.* St. Louis, Iron Mountain, & Southern R. Co. (1878), 5 Dill. 1, citing Albert *v.* Grosvenor Investment Co., *supra.* Treat, J., dissented, concluding from an examination of the evidence in the case, which was very voluminous, that the bondholders were equitably estopped to foreclose the mortgage until the end of the stipulated period, provided one-half of the interest was paid.

[4] South St. Louis R. Co. *v.* Plate (1887), 92 Mo. 614; S. C. 5 S. W. Rep. 199.

obligation of the parties, and the mortgage a mere security for the performance of that obligation, the terms of the bonds are controlling in regard to the question whether demand is or is not necessary to render the default complete.[1] (But see Chap. II., *ante*.)

§ 389. **What amounts to a Default where Bondholder is receiving the Income of the Mortgaged Property.** — Where the holder of the bonds sued upon is a railroad company which has leased the mortgaged road, and, in place of paying rent, has agreed to apply the net earnings to the payment of the interest coupons, the complainant must, in order to establish a default, show that such earnings have been insufficient to pay the coupons.[2]

§ 390. **Defaults in the Payment of Interest on Divisional Bonds are not available in a Suit to foreclose a Consolidated Mortgage.** — This is true even if the complainant has paid the divisional bondholders, so as to become subrogated to their rights. Such rights are limited to the separate divisions of the road, and must be asserted against the specific property mortgaged.[3]

§ 391. **What is a Sufficient Demand, where that is required before bringing Suit.** —The opinion has been expressed that a paper addressed to a railroad company, which, after reciting that payment of certain interest coupons had been demanded, and refused, and that the holder will look to the company for payment thereof, is a sufficient compliance with an article of the mortgage to the effect that there shall be a "demand made in writing;" but the case was decided on another point.[4]

§ 392. **Presentation of Coupons at Place designated for Payment of Interest when not a Condition Precedent to Suit thereon.** — Generally a suit may be brought on any commercial paper payable at a particular place, without demand at that place.[5]

This rule is applicable to a suit to enforce overdue coupons although the bond promises to pay the principal and "interest

[1] Railroad Co. *v.* Sprague (1880), 103 U. S. 756, 761. In this case the mortgage declared that the principal sum became due after a six months' default in the payment of interest, whether it had been demanded or not, while the bonds declared this result would follow if the default continued for that space of time after demand of payment.

[2] Chamberlain *v.* Connecticut Central R. Co. (1889), 54 Conn. 472; s. c. 9 Atl. Rep. 244, where it was also held that, in accounting for the receipts, the lessee was bound to account for and apply the net receipts from the leased road by itself, and had no right to pro-rate them with the receipts from its own road upon the entire mileage.

[3] Union Trust Co. *v.* St. Louis, Iron Mountain, & Southern R. Co. (1875), 5 Dill. 1.

[4] Pennsylvania Co. for Ins. of Lives and Granting Annuities *v.* Philadelphia & Reading R. Co. (1895), 69 Fed. Rep. 482.

[5] Wallace *v.* McConnell (1839), 13 Pet. 136; Montgomery *v.* Elliott (1844), 6 Ala. 701.

at the rate of ten per cent per annum, payable semi-annually on the first days of January and July in each year, *on presentation of the respective coupons hereto attached*, both principal and interest being payable at the financial office of said company in the city of New York. It is no objection to holding the default to be complete without such "presentation" that the bonds also declare that, after a continuance of a default for six months, the principal shall become due. A coupon-holder cannot, by a mere failure to present his coupon for payment when due, accelerate the maturity of the principal under this provision; for the claim that the principal of the bonds had become due by reason of default in the payment of interest would be conclusively answered by an averment of the company that it had funds at the place designated for payment sufficient to pay the coupons if they had been presented.[1]

§ 393. **Waiver of the Right to have Instalments of Interest paid at a Certain Place.** — Where the mortgage stipulates that, upon the continuance of a default for sixty days, the whole principal is to become due and payable at the mortgagee's election, the mortgagee must, if he knows that the mortgagor has an instalment ready at the usual place of payment, and requires payment at the place designated in the mortgage, so notify the mortgagor; and if he fails to do so, and his agent at the usual place of payment refuses to receive payment except on certain conditions, he waives the right to payment elsewhere, and cannot, on default thereof, treat the whole debt as due.[2]

§ 394. **No Relief in Equity against Consequences of Default without Excuse.** — A mortgagor upon whose unexcused failure to pay an instalment of interest the principal sum has been declared due, pursuant to a provision in the mortgage, cannot be relieved in equity from foreclosure for the principal upon payment of interest and costs.[3]

§ 395. **Benefit of Alternative Agreement as to Payment in Scrip not available after Default.** — When the mortgage simply authorizes the trustee to sell the property in case of default as to the principal sum at maturity of the debt, and apply the proceeds to satisfy the amount due, the right to foreclose becomes absolute immediately upon a default in the payment of the interest, and the company cannot afterwards avail itself of a stipulation,

[1] Warner *v.* Rising Fawn Iron Co. (1878), 3 Woods, 514.

[2] Union Mut. Life Ins. Co. *v.* Union Mills Plaster Co. (1889), 37 Fed. Rep. 286.

[3] Warwick Iron Co. *v.* Morton (1891), 148 Pa. 72; s. c. 23 Atl. Rep. 1065.

whereby the company has the option of paying the interest in scrip in case the net earnings should prove insufficient to meet the same. The fact that the mortgagee made no demand for the payment of the interest on the day when it was due is no bar to a foreclosure suit under such circumstances, for the company should then have paid in money or scrip, or shown itself prepared to do so.[1]

Article IV. — Powers of Trustees and Bondholders respectively in Regard to commencing Foreclosure Suits.

§ 396. **Power of Trustee to foreclose considered with Respect to Request from the Bondholders.** — (a) *Request from Bondholders, when necessary.* — The power of the trustees to take the initiative in foreclosure proceedings for the enforcement of the lien is often restricted by some provision requiring them to procure the consent of all or a part of the bondholders before they act in their behalf. Such consent is then an indispensable prerequisite to the validity of a decree of foreclosure.[2]

Thus a provision that, after the principal of the bonds has been declared by the trustees to have become due, by reason of a continuance in the default of the interest for a given period, they shall, "upon the written request of the holders of a majority of the said bonds then outstanding, proceed to collect both principal and interest, by foreclosure and sale of the property or otherwise, as therein provided," does not entitle the trustees, at their option, to file a bill for foreclosure. The office of this clause in reference to the written request of a majority of the bondholders is not merely to make the obligation of the trustees imperative, instead of optional, but it is to be construed as securing to such majority the right to control the proceedings of the trustees. Under the former supposition the provisions as to a request by the majority would be nugatory, inasmuch as the debt having become fully due, by the declaration of the trustees, for all the purposes of the mortgage, it would be in the power of a single bondholder to proceed for himself and his associates directly for the same object, and to procure the same relief.[3]

[1] Marlor v. Texas & Pac. R. Co. (1884), 21 Fed. Rep. 383.

[2] Chicago, Danville, & Vincennes R. Co. v. Fosdick (1882), 106 U. S. 47; s. c. 12 Am. & Eng. R. R. Cas. 367.

[3] Chicago, Danville, & Vincennes R. Co. v. Fosdick (1882), 106 U. S. 47; s. c. 12 Am. & Eng. R. R. Cas. 367, Waite and Harlan, JJ., dissenting, who thought that, though the trustees might possibly be

(b) *Request from Bondholders, when not necessary.* — On the other hand, no request from the bondholders is necessary to entitle the trustee to begin suit when the mortgage expressly provides that, upon the continuance of the default for a specific period, the principal shall immediately become due and payable, although the article containing this provision also states that the trustee, upon the request of the holders of 75 per cent. of the outstanding bonds, may take possession of and operate the road, and that, upon a like request, it shall be the trustee's duty to foreclose the mortgage, and, after advertisement, sell the property at public auction to the highest bidder for cash. Especially must this be regarded as the true construction of the provision when the mortgage contains in another place a clause whereby it is stipulated that nothing therein shall be construed to prevent or interfere with the foreclosure of the instrument, the appointment of a receiver, or any other act or proceeding, appropriate in such cases, in any court of competent jurisdiction. Such a clause, although not imparting any right which does not exist without it, serves to show that the restrictive provisions as to a request by the bondholders are not intended to apply to foreclosure by bill in equity, but merely to the cumulative remedy specified. The reason for the distinction is obvious. The summary proceedings of taking possession and selling may result in injury which cannot be predicated of proceedings regularly taken in a court of equity. In the former case, arbitrary action on the part of the trustee may be deemed undesirable in view of the interests of the mortgagor and of the bondholders as a class. In the latter, each will certainly find the protection to which it may be entitled at the hands of the court.[1]

restrained from going on with a suit, if the majority of the bondholders should interfere in an appropriate way, yet when they all came in and availed themselves of what had been done by the trustees, the corporation itself was in no position to defend because a request had not been formally made in advance. (See p. 80 of opinion.)

[1] Morgan's La. & Texas Railroad & Steamship Co. *v.* Texas Central R. Co. (1891), 137 U. S. 171; s. c. 11 Sup. Ct. Rep. 61; 45 Am. & Eng. R. R. Cas. 63, distinguishing Chicago, Danville, & Vincennes R. Co. *v.* Fosdick, *supra,* as follows: —

"In the case at bar the proof of the presentation and default upon the coupons was full and was not disputed. The mortgages specifically provided that, upon such default continuing for sixty days after demand, the principal of all the bonds should become immediately due and payable. The Texas Company and the Morgan Company both admitted that the principal had become due and payable. The instruments did not require a written request for the declaration by the trustee that the principal was due, or such a declaration and notification to the defaulting company, in order to make the principal mature. That was a consequence of a default continuing sixty days after demand. Nor was there any restriction upon the

§ 397. **Bondholder estopped by Decree, though no Request made.** — Even if a trustee is not entitled to foreclose without the request of the holders of a certain percentage of the bonds, a bondholder is estopped to complain of a decree rendered in a suit brought by the trustee if, with a full knowledge of all the facts, he proves before the master bonds of a value exceeding that percentage.[1]

§ 398. **Default may be taken Advantage of by a Single Bondholder, unless the Mortgage provides otherwise.**[2] — This rule is based upon the simple principle that the failure to pay even one of the instalments of interest is a breach of the conditions of the trust deed, the declared purpose of which is to secure the payment of the principal as well as the interest.[3]

The right of a coupon-holder to foreclose for default in the payment of interest is not affected by a provision in the mortgage that, if the interest shall remain unpaid for a given period, the principal shall become due, and that the trustees "may, and upon the written request of a majority in amount of the bonds shall, . . . within a reasonable time proceed to foreclose the mortgage." Such a clause is operative as a restriction upon the coupon-holder's right to bring suit, only when it is sought to take advantage of the default as advancing the date when the principal becomes due.[4]

The reasons for not denying to individual bondholders the right to foreclose are still stronger where the mortgage expressly provides that they may not levy upon any part of the mortgaged premises.[5]

This right of the individual bondholder is not however carried to the extent of allowing him to obtain a decree for his exclusive benefit. He is bound to act for all standing in a similar position, and not only to permit other bondholders to intervene, but to see that their rights are protected in the final decree.[6]

power to proceed by bill in equity, but, on the contrary, any intention to impose such a restriction was disowned."

As to the reasons here assigned for placing such special limitation upon the power of the trustee to resort to the summary remedies given by the mortgage, compare the remarks of Brewer, J., in Mercantile Trust Co. *v.* Missouri, K. & T. R. Co. (1888), 36 Fed. Rep. 221; 36 Am. & Eng. R. R. Cas. 259.

1 Credit Co. *v.* Arkansas Central R. Co. (1882), 15 Fed. Rep. 46.

2 Chicago, Danville, & Vincennes R. Co. *v.* Fosdick (1882), 106 U. S. 47; s. c. 12 Am. & Eng. R. R. Cas. 267, from which a quotation was made, *supra.*

3 Farmers' Loan & Trust Co. *v.* Chicago & A. Ry. Co. (1886), 27 Fed. Rep. 152; Pennsylvania Co. for Ins. on Lives and Granting Annuities *v.* Philadelphia & Reading R. Co. (1895), 69 Fed. Rep. 482.

4 Beekman *v.* Hudson River & West Shore R. Co. (1888), 35 Fed. Rep. 3; s. c. 4 Ry. & Corp. L. J. 220; compare Pennsylvania Co. for Ins. on Lives and Granting Annuities *v.* Philadelphia & Reading R. Co. (1895), 69 Fed. Rep. 482.

5 Pennsylvania Co. for Ins. on Lives and Granting Annuities *v.* Philadelphia & Reading R. Co. (1895), 69 Fed. Rep. 482.

6 New Orleans & Pacific Ry. Co. *v.* Parker (1891), 143 U. S. 42; s. c. 12 Sup. Ct. Rep. 364.

The right of an individual bondholder to begin suit is sometimes circumscribed by the provisions of the mortgage. A stipulation therein that no proceedings shall be taken by any bondholder secured thereby to foreclose independently of the trustee, until after the refusal of the trustee to comply with a requisition first made upon him by a certain percentage of the bondholders, is reasonable and valid. It is not the purpose and effect of such a stipulation to divest the bondholders of their rights to judicial remedies, or to oust the courts of their jurisdiction, but it is merely the imposition of certain conditions upon themselves in respect to the exercise of that right.[1] In this connection compare the "debenture-holder's action" in England.

So a provision in a mortgage that "no suit, action, or proceeding for its foreclosure or for the execution of the trusts or other remedy, shall be brought or instituted except by the trustee after notice upon default, upon request in writing of one-fifth in value of the holders of the bonds and the offer of indemnity against costs," is binding on the bondholders in the absence of fraud or mismanagement on the part of the company.[2]

§ 399. **A Majority of the Bondholders may sometimes prevent a Foreclosure for Interest at the Instance of some of their Co-bondholders.** — Thus it has been held that where the mortgage secures bonds to the amount of $1,500,000, which had several years to run, and were above par in the market, and it appeared that the foreclosure suit was begun in behalf of holders of only $79,000 worth of the bonds, and was instituted for the purpose of reorganizing the company, and compelling the bondholders to take the sums due to them or accept a lower rate of interest, those bondholders who did not wish to foreclose should be allowed to purchase the bonds of those who did wish to foreclose, and stop the proceedings upon payment of all costs and expenses.[3]

So a single holder of bonds, providing that the principal shall become due upon default in the payment of interest, cannot recover such principal upon default in the payment of interest, where the scheme of payment provided in the mortgage shows that the intention was that the bondholders should look to the mortgaged

[1] Seibert *v.* Minneapolis & St. Louis Ry. Co. *et al.* (Grigges, Intervener, 1893), 52 Minn. 148; s. c. 53 N. W. Rep. 1134; 57 Am. & Eng. R. R. Cas. 209; Guilford *v.* Minneapolis, S. Ste. M. & A. Ry. Co. (1892), 48 Minn. 560; s. c. 51 N. W. Rep. 658.

[2] McGeorge *v.* Big Stone Gap Improvement Co. (1893), 57 Fed. Rep. 262.

[3] Tillinghast *v.* Troy & Boston R. Co. (1888), 48 Hun, 420; s. c. 1 N. Y. Suppl. 243.

property for repayment, and that foreclosure should rest in the discretion of the majority of the bondholders.[1]

ARTICLE V. — EFFECT OF PROVISIONS ACCELERATING THE MATURITY OF THE DEBT UPON DEFAULT IN PAYMENT OF INTEREST.

§ 400. **Generally.** — A common provision in mortgages is that, on the continuance of a default in the payment of interest for a specified period, the principal shall become due either absolutely or at the option of the trustees. Whether this right to accelerate the time of payment exists is a question which must be decided by the circumstances existing when it was made. It cannot be supported by subsequent occurrences.[2]

The right must also be granted in express terms, for the court cannot engraft a clause for that purpose on the contract.[3]

Thus, if the principal is to become due at the election of the trustees, it must be shown that they have exercised their right of election.[4]

[1] Batchelder *v.* Council Grove Water Co. (Superior Ct. N. Y., 1891), 38 N. Y. St. Repr. 529; s. c. 14 N. Y. Suppl. 306.

[2] Chicago, Danville, & Vincennes R. Co. *v.* Fosdick (1882), 106 U. S. 47.

[3] McFadden *v.* Mays Landing & Egg Harbor City R. Co. (1891), 49 N. J. Eq. 176; s. c. 22 Atl. Rep. 932, where it was held that the right of a bondholder to demand the discharge of the principal after a default in the interest could not be inferred from a clause in the mortgage empowering the trustee, after such a default had continued for a stated time, to take possession of the mortgaged property and apply the proceeds to the payment of interest and principal. See also Chicago, Danville, & Vincennes R. Co. *v.* Fosdick, 106 U. S. 47, where it was denied that a provision whereby, in the event of a foreclosure and sale for non-payment of interest, whether on one or more coupons, the property is to be sold as an entirety, and free of the incumbrances of the mortgage, so as to pass all the title, both of mortgagor and mortgagee, and the proceeds of the sale are to be applied, after payment of overdue interest, to the payment of the principal of the debt, though not yet due, had the effect of making the whole debt due before the stipulated day of payment.

Nor will a power to declare the principal due be inferred from provisions to the effect that (1) the trustee, when in possession, may apply the residue of income on the principal of outstanding bonds; (2) that he may cause the property to be sold as an entirety; and (3) that, if he is proceeding to sell the property for default in interest, the mortgagor, at any time before sale is made, may pay all interest then in arrear, costs, expenses, disbursements, and reasonable compensation, and that thereupon the trustee shall discontinue the proceeding and surrender the possession. Grape Creek Coal Co. *v.* Farmers' Loan & Trust Co. (1894), 63 Fed. Rep. 891; s. c. 12 C. C. A. 350; citing Chicago, Danville, & Vincennes R. Co. *v.* Fosdick, *supra.*

The word "foreclosure" itself, in a restrictive provision, must be construed with reference to the context. Thus, where the mortgage provides that "foreclosure shall not take place until ninety days after publication of the commencement of proceedings to that end shall have been made," such notice applies to the foreclosure itself, not to the bringing of the suit for foreclosure. Hodder *v.* Kentucky & Great Eastern Ry. Co. (1881), 17 Fed. Rep. 793. And the provisions of a clause giving the power must be strictly followed.

[4] Randolph *v.* Middleton (1875), 26 N. J. Eq. 543.

§ 401. **Default when complete so as to render Principal due.** — A provision in a bond that, "in case of the non-payment of any coupon, . . . if such default shall continue for six months after maturity and demand of payment, the principal of the bond shall become immediately due and collectible," has the effect of constituting a period of contract grace distinct from the period of commercial grace, — not an additional period, but another; not one to be tacked on to the period of commercial grace, but one to be substituted therefor; and, like days of commercial grace, to be computed from the day of payment named in the promise to pay. The right to foreclose is complete when the period of contract grace expires. Time being of the essence of the contract, a court of equity will not relieve the party interested in preventing the maturity of the bonds from the consequences of failure to make payment, or tender of payment, of the interest before the end of the six months, especially if there has been a systematic postponement of the payment of several previous instalments of interest to the very end of the period.[1]

Where the payment of the principal of a bond secured by a mortgage is postponed for several years conditioned upon the payment of the interest semi-annually, and in default of the payment of the interest for thirty days the principal shall become due at the option of the mortgagee, such mortgagee will be entitled to a decree foreclosing the mortgage, and declaring the whole amount of principal and interest due upon default in any of the payments of interest, according to the condition in case of no responsibility for such defaults upon the part of the mortgagee, notwithstanding he waived one previous default by accepting the interest, the non-payment of which had occasioned such default.[2]

Under a trust deed providing that, on default "after demand" for a period of six months, the trustee may sell the property, and that, "in the event of any default in the payment of interest for a period of six months, the whole principal shall become due, there is no default except upon refusal to pay after a demand has been made; and such default must continue for the period named before an action can be commenced to foreclose the mortgage." The word "default," as used in the second provision, is deemed to have the same meaning as in the first provision, viz., a default after demand.[3]

[1] Alabama & Georgia Mfg. Co. *v.* Robinson (1893), 56 Fed. Rep. 690; s. c. 6 C. C. A. 79; 13 U. S. App. 359.

[2] Post *v.* Industrial Land Development Co. *et al.* (N. J. Eq., 1896), 34 Atl. Rep. 137. See, on this point, Baldwin Investment Co. *v.* Bailey *et al.* (1895), 45 Neb. 580.

[3] Potomac Mfg. Co. *v.* Evans (1888), 84 Va. 717; s. c. 6 S. E. 2.

§ 402. **Rights of Minority Bondholders under Provisions as to Acceleration of Maturity of Debt.**[1] — Where it is stipulated that the bonds are not to mature for twenty years, and the mortgage also contains a provision that bonds may be considered due by any bondholder on default of interest for a specified period, and that the mortgage may then be foreclosed, each bondholder takes his bonds subject to this right of his co-bondholders, and cannot, by electing not to have his own bonds become due, obstruct the action of the majority, who desire to foreclose the mortgage and carry out a scheme of reorganization sanctioned by the legislature.[2]

§ 403. **Acceleration of Maturity prevented by Words of Statute authorizing Issue of Bonds.** — The words of the statute authorizing the issue of the bonds may be such that the maturity of the debt cannot be accelerated even by an express provision in the mortgage, as where it is declared that the bonds are "not to mature at an earlier period than thirty years." Such a declaration "differs widely from a mere direction as to the length of time the bonds should run, or the period when they should be made payable," and is to be construed as an express enactment that they shall not mature earlier.[3]

[1] As to the rights of majority and minority bondholders generally, see Chap. II., *supra*.

[2] Gates *v.* Boston & New York Air Line R. Co. (1885), 53 Conn. 333, 347; s. c. 5 Atl. Rep. 695. The court said: "When it was provided in the bonds and mortgage that the bonds were payable in twenty years from date, it was also provided by the bond, the mortgage, and the law [under which the mortgage was executed], that, under certain circumstances, at the option of the bondholders and the trustee, the bonds should mature and the mortgage be foreclosed before that time, thus preventing the contemplated running for twenty years. The provision that the bond should continue for twenty years an outstanding subsisting security, if any existed, was with reference to the corporation. The provision that the bonds by the action of the bondholders might mature before that time was in reference to the co-bondholders. And while it would impair the obligation of a contract, if such existed, so far as the corporation is concerned, to change the time of maturity, it does not have that effect when the co-bondholders proceed upon their common and undisputed right to cause the bonds to mature, and by foreclosure to discharge the bonds by taking the property in a legal way."

[3] Howell *v.* Western Railroad Co. (1876), 94 U. S. 463.

Some statutory provisions relating to foreclosure: Kansas, G. L. 1889, §§ 1248 and 1276; Maine, R. S. 1893, ch. 51, § 91; New Jersey, Supp. Rev. 1877 to 1886, p. 845; New York, Banks & Bros., R. S., 9th ed., p. 1005; North Dakota, Code 1895, § 2947, subs. 11.

CHAPTER XX.

REMEDIES OF BONDHOLDERS. — STRICT FORECLOSURE.

§ 404. **Generally.** — A decree for strict foreclosure provides for payment by a day named, or, in default thereof, that the conveyance shall become absolute and the equity of redemption foreclosed and barred. To what extent the remedy of strict foreclosure may be pursued is now very generally regulated by statute. Where it is allowed, it is confined to a very limited class of cases,[1] and these perhaps occur less frequently where railroad mortgages are in question than any others.

Where the requisites of a valid strict foreclosure are a matter of statutory regulation, the directions of the enactment must be strictly complied with. Thus, if it is provided that foreclosure shall be by peaceable entry, one year's possession, and publication of notice, actual notice is not sufficient, but the notice must be actually published.[2]

§ 405. **Remedy not generally suitable in the Case of Railroad Mortgages.** — The great objection to granting a strict foreclosure of a railroad mortgage is, that it must commonly result in making a large number of persons virtual co-tenants of the property, and probably lead to a renewal of the very troubles which have led to the institution of the foreclosure proceedings.

In Ketchum *v.* Duncan[3] the court said: "That a sale was properly directed here rather than a strict foroclosure is quite evident. It was the object of all the consolidated bills to procure a sale, and if there was not assent by all parties, there was at least no objection to it. A strict foreclosure would not have converted the property into money. It would, in fact, have

[1] A useful summary of cases will be found in the note appended to Clark *v.* Reyburn, 75 U. S. 318, in the Lawyers' Co-operative Edition (Bk. 19, p. 354). See further in 2 Mo. West. Jurist, 643.

[2] Ashuelot R. Co. *v.* Elliot (1873), 52 N. H. 387.

[3] 96 U. S. 659, 671 (1877).

required the creditors to advance more funds to pay the costs and expenses. This no bondholder could justly require from his associates. Besides, a strict foreclosure could not be a winding up of the matter. It would leave an undivided beneficial interest in an unmanageable property in the hands of a large number of persons, who are very likely to disagree in regard to its use." It was then shown that the same objections were applicable to a purchase by the trustee, the opinion of the court being summed up thus: "It is too plain for any further comment that neither a strict foreclosure, nor a purchase by a trustee to buy, would have been for the interest of any bondholder."

So also in Sage *v.* Central R. Co.,[1] although the specific relief asked for was a strict foreclosure, a decree for a sale was held to be unquestionably appropriate under the prayer for general relief, and the reasons for making such a decree in the given case were thus explained: "A strict foreclosure was undesirable for all parties. Not only would it have cut off entirely the bondholders secured by the second and third mortgages, whose interests were before the court, and which it was bound to protect as far as possible, but it would have made a large number of bondholders under the first mortgage practically tenants in common of the railroad property. The inconveniences of such a result are obvious enough. A sale therefore was for the interest of all, and to that no one objected. Indeed it was contemplated as possible in each of the three mortgages. The bondholders, through their trustee, had made arrangements in view of such a contingency. They had agreed what should be the effect and consequence of a judicial sale." It was therefore held that, as the deed of trust containing this agreement had been made part of the bill, it was not going outside of the case to enforce it.

[1] 99 U. S. 334 (1878).

CHAPTER XXI.

JURISDICTION.

Article I.—How far the Prior Control of the Subject-matter invests a Court with Exclusive Jurisdiction of a Suit, and Jurisdiction generally.[1]

§ 406. **The General Rule as to Control of Litigation by Courts of Concurrent Jurisdiction.** — It is stated in its most comprehensive

[1] On jurisdiction to hear appeal, see Chap. XXXVIII.; on binding effect of decrees and judgments, see Chap. XXXIII.; on jurisdiction to decree sale of property in another State, see Chap. XXXV. (sales); as to the exclusive jurisdiction of courts

form by Justice Grier in the following passage of his opinion in Peck *v.* Jenness;[1] "It is a doctrine of law too long established to require a citation of authorities, that, where a court has jurisdiction, it has a right to decide every question which occurs in the cause, and whether its decision be correct or otherwise, its judgment, till reversed, is regarded as binding in every other court; and that where the jurisdiction of a court, and the right of a plaintiff to prosecute his suit in it, have once attached, that right cannot be arrested or taken away by proceedings in another court."

The rule is, therefore, universally applied that, in all cases in which the jurisdiction of Federal and State courts is concurrent, neither can impede or arrest any action which that other may take within the limits of its jurisdiction.[2]

This rule prevails even though there are irregularities and defect in the proceedings of the sister court which render them void.[3]

Where a citizen of another State brings an action in a federal court in the State of which a railroad company is a citizen against such company to enforce an express lien upon the accrued earnings and income, without seeking to disturb the prior liens, and in advance of an application for foreclosure of a mortgage, the court will have jurisdiction to take possession of the property of the company and appoint a receiver for the same.[4]

And the court, having acquired jurisdiction of the property and appointed receivers with the express consent of the railroad company, does not lose jurisdiction when other persons interested therein come in and are made parties, even though some of them be citizens of the same State with those whose interests in the same property are adverse to the interveners; for when property is in the actual possession of the federal court this draws to it the right to decide upon conflicting claims as to its ultimate possession and control.[5]

appointing a receiver, see Chap. XXVI.; on the extra-territorial jurisdiction of receivers, see Chap. XXVI.

[1] 7 How. 612 (1849).

[2] Amy *v.* Supervisors (1870), 11 Wall. 136; Freeman *v.* Howe (1860), 24 How. 450; Taylor *v.* Carryl (1857), 20 How. 583; Peck *v.* Jenness (1849), 7 How. 612, 625; Hagan *v.* Lucas (1836), 10 Pet. 400; Pullman *v.* Osborne (1854), 17 How. 471; Parker *v.* Aldridge (1881), 8 Fed. Rep. 220, 223; Alabama & Chattanooga R. Co. *v.* Jones (1875), 7 N. B. R. 169; Bruce *v.* Manchester & Keene Railroad (1884), 19 Fed. Rep. 342, 344. The last case cites a large number of authorities.

[3] Lewis *v.* The Ship Orpheus (1858), 3 Ware, 143.

[4] Park *v.* New York, Lake Erie, & Western R. Co. *et al.* (1895), 70 Fed. Rep. 641.

[5] Park *v.* New York, Lake Erie, & Western R. Co. *et al.* (1895), 70 Fed. Rep. 641, upon authority of Morgan's La. & Tex. Ry. & Steamship Co. *v.* Texas Central Ry. Co. (1890), 137 U. S. 171, 201; s. c. 11 Sup. Ct. Rep. 61; Freeman *v.* Howe (1860), 24 How. 450, 466; *In re* Tyler (1893), 149 U. S. 164, 181; s. c. 13 Sup. Ct. Rep. 785; Rouse *v.* Letcher (1895), 156 U. S. 49; s. c. 15 Sup. Ct. Rep. 266; Central Trust Co. *v.* Bridges (1893), 57 Fed. Rep. 753; s. c. 6 C. C. A. 539;

And the court may in such a case retain the jurisdiction which it has acquired to dispose of the claims of all parties appearing, whatever their citizenship.[1]

Nor will the jurisdiction of the court be arrested by the fact that, after the action is begun by service of summons, the defendant does not continue to resist the demands of the complainant.[2]

Where there has been a default in interest on the bonds of a railroad company which has mortgaged its property lying in two States, and the required majority in value of the bondholders have requested the trustee to foreclose, and the trustee has brought an action in the State court of one of the States, which the company has had enjoined in that court, the bondholders may request the trustee to bring an action in the other State, and if he fails to comply, may bring it in their own names for the benefit of all others interested. And where the parties in interest, after the filing of such bill, have appeared and answered, the court will have jurisdiction to foreclose the mortgage upon all the property in the two States.[3]

§ 407. **Application of General Rule to Process from Different Courts.** — That property seized under an execution by the officer of one court cannot be subjected to process issuing out of another court has always been a well-recognized doctrine; but its precise scope was perhaps not thoroughly understood before the decision in Freeman *v.* Howe, which elicited a noteworthy conflict of opinion between two courts of the very highest authority.[4]

In that case a United States marshal attached certain rolling-stock to satisfy a judgment recovered upon the bonds of a railroad company, and the trustees thereupon replevied the property in a State court. This action was upheld by the Supreme Court of Massachusetts on the ground that the case in which the judgment had been recovered involved only the question of the contract liability of the railroad company, and the decision of such a matter would not be affected by the possession of the rolling-stock by

Farmers' Loan & Trust Co. *v.* Houston & Texas Central R. Co. (1890), 44 Fed. Rep. 115.

[1] Farmers' Loan & Trust Co. *v.* New York, Lake Erie, & Western R. Co. (1895), 70 Fed. Rep. 641.

[2] Park *v.* New York, Lake Erie, & Western R. Co. *et al.* (1895), 70 Fed. Rep. 641.

[3] Woodbury *v.* Allegheny & K. R. Co. *et al.* (1895), 72 Fed. Rep. 371, upon authority of Muller *v.* Dows (1876), 94 U. S. 444; Massie *v.* Watts (1810), 6 Cranch, 148; Bradley *v.* Chester Valley R. Co. (1863), 36 Pa. St. 141; Burnley *v.* Stevenson (1873), 24 Ohio St. 474; McElrath *v.* Pittsburg & Steubenville R. Co. (1867), 55 Pa. St. 189, 208.

[4] 24 How. 450; s. c. 14 Gray, 566, *sub nom.* Howe *v.* Feeeman (1860). In Buck *v.* Colbath (1865), 3 Wall. 334, it was admitted that "this decision took the profession by surprise."

the marshal. That property, it was argued, could not be regarded as having been made subject to the jurisdiction of the federal court by a process which was merely a command to the marshal to seize the property of the railroad company, and not a warrant to seize these particular cars. The question of the ownership of the cars was an entirely collateral question, which the federal court did not decide in the action pending before it, and if they were really the property of the trustees under the "after-acquired property" clause of the mortgage, they were not taken in pursuance of the precept issued to the marshal. The Supreme Court of the United States, to which the case was removed on a writ of error, declined to accept this view, and held that the interference with the possession of the marshal was entirely irregular. The question as to which authority was to prevail under the given circumstances did not, as was declared, depend upon the rights of the respective parties to the property seized, but upon the question which jurisdiction had first attached by the seizure and custody of the property under its process.[1]

The converse of the rule applied in Freeman *v.* Howe also holds, and property levied upon by the sheriff of a State court cannot be taken in execution by a United States marshal.[2]

Nor can a federal court, at the instance of the mortgagees, enjoin a sheriff from selling the railroad's property under an execution issued from a State court.[3]

§ 408. **Possession of Receiver not interfered with by other Courts.** — That property lawfully in the hands of a receiver duly appointed by a court of competent jurisdiction cannot be affected by litigation in a co-ordinate court follows directly from the same principle which exempts property in the hands of a sheriff from external interference. This rule and its qualifications will be discussed in a later chapter.

§ 409. **Jurisdiction of Court exclusive as to Proceedings taken to set aside or enforce Decrees or Judgments rendered by it.** — The immunity from interference to which the court which first obtains control of the *res* is entitled extends also to the proceedings taken to enforce judgments. Thus, if a *mandamus* is obtained from a federal court to compel a town to pay a judgment recovered against it by a holder of its bonds, issued to aid a railroad, the

[1] The laws of Scotland were held to control in determining the question of priorities to calls on stock held there, in a winding-up proceeding in England. *In re* Queensland Mercantile Agency Company (1891), 1 Ch. Div. 536; affirmed (1892), 1 Ch. (C. A.) 219.

[2] Hagan *v.* Lucas (1836), 10 Pet. 399; Taylor *v.* Carryl (1857), 20 How. 583.

[3] Ruggles *v.* Simonton (1872), 3 Biss. 325.

fact that a State court has issued an injunction prohibiting the payment of the judgment is no excuse for disobedience to the writ.[1]

So also a suit to set aside a foreclosure is so far auxiliary to the original suit that it can only be instituted in the court where the decree was rendered[2] (unless the application is made on the ground of fraud; see *post*).

This rule that a suit to set aside a foreclosure decree on the ground of fraud is an ancillary suit so far as the jurisdiction of the federal courts is concerned will prevent an appeal to the Supreme Court of the United States under the act constituting the Circuit Court of Appeals in any case in which the jurisdiction is entirely dependent upon the opposite parties to the suit or controversy being aliens and citizens of the United States, or citizens of different States.[3]

A suit by a judgment creditor, brought for the purpose of ascertaining the rank of the lien which he holds, is also so far ancillary to a foreclosure suit involving the same property that jurisdiction to hear it need not be acquired by any fresh service of process upon the parties already in court.[4]

But a creditor's bill in aid of an execution issuing out of a State court may be filed in a federal court.[5]

§ 410. **Exclusiveness of Jurisdiction in Respect to Subject-matter of Foreclosure Suits.**[6] — The jurisdiction acquired by a bill to foreclose a mortgage on the defendant's property extends to the whole subject-matter of the litigation, and invests the court with authority to hear and determine all collateral issues that may be involved in the controversy.[7]

Thus a bill which requires a construction of the orders and

[1] Riggs *v.* Johnson County (1867), 6 Wall. 166, 184; Supervisors *v.* Durrant 1869), 9 Wall. 415, 417.

[2] Pacific R. Co. *v.* Missouri Pacific R. Co. (1880), 3 Fed. Rep. 772. Such a suit, however, partakes so far of the nature of an original bill, that the parties cannot be brought into court in any other way than by subpœna. Ibid.

[3] Carey *v.* Houston & Texas Central Ry. Co. (1896), 161 U. S. 115.

[4] Hays *v.* Alexandria & Washington R. Co. (1882), 4 Hughes, 331.

[5] Pullan *v.* City of New Albany (1869), 4 Biss. 365, 368, decided mainly on the authority of Shields *v.* Thomas (1855), 18 How. 253, and Barber *v.* Barber (1868), 21 How. 582, in which a prior decree had been rendered in another State. The court deemed this circumstance of no importance, referring to Ogilvie *v.* Knox Ins. Co. (1859), 22 How. 380; s. c. 2 Black, 539, where a bill filed under these circumstances was sustained, though no question of jurisdiction was actually raised.

[6] As to cases in which a receiver has been appointed in a foreclosure suit, see Chap. XXVI., *post*.

[7] Kennedy *v.* I., C. & L. R. Co. (1880), 3 Fed. Rep. 97, 105, following Davis *v.* Gray (1872), 16 Wall. 203.

decrees made in a foreclosure suit is properly brought in the court where that suit was instituted.[1]

So also a decree of foreclosure rendered in a State court and still in full force is a bar to a suit in a federal court by a shareholder who seeks, among other things, the removal of the trustees. The petitioner has an ample and complete remedy for his alleged grievances in the State court, and there is no occasion for his application to the federal court.[2]

A corporation which is the principal defendant in a foreclosure suit cannot invoke by suit another court to restrain such action, but is bound to plead any facts, — such, for instance, as that the bonds secured by the mortgage have been fraudulently issued, or without consideration by answer or cross-complaint in the foreclosure suit. If it should not prosecute its defence, or fails to answer, its stockholders may intervene, cause all necessary parties to be brought in, and show all the facts which may be essential to a complete defence.[3]

So where a State court has decreed the foreclosure of a mortgage and the sale has taken place, a federal court will decline to entertain a bill to place the trustees in possession, although such bill was filed before the sale, and the sale when made was declared to be subject to the result of the suit in the federal court.[4]

So a federal court will refuse to enforce a judgment upon the property of a railroad company which a State court has ordered to be sold in foreclosure proceedings instituted by the bondholders.[5]

So where a foreclosure suit in a federal court is compromised, and a scheme of reorganization adopted and ratified by a decree of the court, the trustee of the property appointed to carry out the scheme cannot lawfully proceed to foreclose in a State court the mortgage which was the subject of the first suit. A sale of the property made by the State court under such circumstances is an unauthorized interference with the control of the federal court; and as the jurisdiction of the latter is not divested thereby, the holder of a bond secured by a subsequent mortgage is entitled to its interposition to protect his rights, and to demand an account from the trustees.[6]

[1] Minnesota Co. *v.* St. Paul Co. (1864), 2 Wall. 609.

[2] Graham *v.* Boston, Hartford, & Erie R. Co. (1883), 14 Fed. Rep. 753.

[3] Waymine *et al.* *v.* San Francisco & S. M. Ry. Co. *et al.* (Cal.), 75 Fed. Rep. 1086 (1896).

[4] Bruce *v.* Manchester & Keene Railroad *et al.* (1884), 19 Fed. Rep. 342.

[5] Fox *v.* Hempfield Railroad Co. (1870), 2 Abb. U. S. 151.

[6] Bill *v.* New Albany, etc. R. Co. (1870), 2 Biss. 390 ; s. c. 3 Fed. Cas. 379, Case No. 1407.

It is sometimes desirable, for the sake of simplifying the litigation, that a co-ordinate court should refrain from exercising its technical rights. Thus where there is a general mortgage on a composite system of roads situate in different States, and various underlying mortgages on the several divisions, it is advisable, for the sake of avoiding unseemly collisions and conflicts of courts, that any suit instituted to foreclose divisional mortgages, after the general mortgage is already under foreclosure in a federal court, should be carried on in the federal courts of the various districts, so that if it should be necessary to resort to an appellate tribunal there will be but one to pass upon the matters in dispute.[1]

§ 411. **Suit in Co-ordinate Court permissible where Possession of First Court is not interfered with.** — As the exclusiveness of the jurisdiction of the first court in this class of cases is predicated on the ground that suits in another court would interfere with its control of the subject-matter of the litigation, it necessarily follows that suits which do not interfere with its possession may be prosecuted elsewhere. "To exclude other courts, the first court should be so administering the property, by virtue of its prerogatives and functions as a court, as to draw the control of the property and its avails to the court as such, and to make the decision of questions respecting it necessary in order to award it to the rightful claimant and put it out of court." [2]

The mere fact that the effect of the judgment or decree of one court may be to modify or control the suit in another court, and to limit or guide its decision, is no reason why the two courts should not take jurisdiction of different actions respecting or growing out of the same subject-matter.[3]

A federal court, therefore, will take jurisdiction of a case involving the same subject-matter as a suit already before a State court of concurrent jurisdiction, if a full disposition of the case can be made without disturbing the possession of the latter court.[4]

Thus the pendency of a general creditor's bill in a State court, accompanied by the usual orders of injunction, but not by the appointment of a receiver, will not prevent a creditor who is not a party to the bill from suing in a federal court to recover the

[1] Central Trust Co. *v.* Wabash, St. Louis, & Pac. Ry. Co. (1886), 26 Fed. Rep. 74, 77.

[2] Andrews *v.* Smith (1881), 5 Fed. Rep. 833, per Wheeler, D. J.

[3] Harrison Wire Co. *v.* Wheeler (1882), 11 Fed. Rep. 206.

[4] Andrews *v.* Smith (1881), 5 Fed. Rep. 833; s. c. 19 Blatch. 100; Logan *v.* Greenlaw (1882), 12 Fed. Rep. 10, 18; Buck *v.* Colbath, 3 Wall. 342.

amount due on certain coupons. Especially is this the case where such creditor merely seeks to reduce his claim to judgment, and not to subject the property of the company to its payment.[1]

So a suit by a bondholder for foreclosure and the removal of the trustees will not be dismissed by a federal court for the reason that one of them has been appointed receiver in a foreclosure suit in a State court, though it will do nothing to interfere with the receiver's possession. The fact that the federal court cannot settle the receiver's accounts in the suit before it will not prevent it from proceeding to a decree of foreclosure.[2]

So a foreclosure suit may be instituted against the mortgagor after the property has been surrendered to the trustees in pursuance of the mortgage, and has not since been in the possession of the mortgagor or of any one claiming under him by any title subsequently acquired.[3]

In an action by stockholders or officers of a corporation in one State against officers in possession disputing the right of the latter to hold their offices, the court has no jurisdiction to enjoin the trustee of bondholders from proceeding to foreclose the mortgage given as security when the terms of the mortgage justify such foreclosure in the courts of the State where the property lies.[4]

(The circumstances under which suits respecting property which is being administered by a receiver may be entertained by a co-ordinate court are discussed in Chap. XXVII., *post.*)

§ 412. **Second Court may pass upon Questions not raised in First Suit.** — A second exception to the general rule is, that a federal court, although it will not interfere with the possession of a State court, may properly pass upon questions not raised in the latter, even though the parties and subject-matter are identical in the second suit.[5]

Thus a federal court will inquire into the nature of the possession of the State court, and if a trust appears, which was not involved in the first suit, will assume the control of it.[6]

§ 413. **Jurisdiction as to Decrees obtained by Fraud in other Courts.** — A third exception to the general rule is recognized in cases where a party applies to a court alleging that a decree

[1] Parsons *v.* Greenville & Columbia R. Co. (1876), 1 Hughes, 279.

[2] Mercantile Trust Co. *v.* Lamoille Valley R. Co. (1879), 16 Blatch. 324.

[3] Brooks *v.* Vermont Central R. Co. (1878), 14 Blatch. 463.

[4] Schmidt *et al.* *v.* Mitchell *et al.* (Ky.), 32 S. W. Rep. 599 (1895); Same *v.* Same (Ky.), 33 S. W. Rep. 408 (1895).

[5] Alabama & Chattanooga R. Co. *v.* Jones (1875), 7 N. B. R. 169.

[6] Watson *v.* Jones (1871), 13 Wall. 679, 718.

obtained in a court of concurrent jurisdiction is tainted with fraud. This principle has been formally stated in the following words: "Wherever, in a direct proceeding, there are parties before a court other than that in which a decree has been rendered, and it is charged that the decree was fraudulent, the court can entertain jurisdiction, and, if the fraud is proved, can prevent all parties who are before it from enforcing, and, of course, from obtaining, any advantage from a sale made thereunder. The court acts upon the decree and sale through the parties who are before it, not directly upon the decree in the other court, but adjudges that, notwithstanding the decree the parties who obtained it, and those before the court who claim property by virtue of a sale under it, with knowledge of the fraud, shall not appropriate to their use the property thus acquired. To this extent a federal court can affect the operation of a decree of a State court, and it cannot be contended that, in such a case, the federal court has no jurisdiction to interfere with, set aside, or annul the decree of the State court, for the reason that the latter belongs to another sovereignty." [1]

A federal court is not precluded from opening up the decree of a State court for fraud, merely because the State legislature has enacted that, if the parties interested in the property omit, after due notice given, to present their objections to the sale on the ground of informalities in the proceedings, the judgment of confirmation shall be conclusive on all the world.[2]

It has, however, been held that this power of a federal court to set aside or revise, on the ground of fraud, a final decree rendered in a State court is limited to those cases in which the injured party has had no opportunity to apply to the State court.[3]

Courts should refrain from interfering with the decrees of other courts, except when such interference is plainly necessary; and this rule is especially applicable where the party applying to the second court for relief has already sought the interposition of the first court, and that court has passed on his demand adversely.[4]

§ 414. **Citizenship of Parties to Ancillary Proceedings is not material.** — If the original suit was properly brought in a federal court, the fact that litigation growing out of and dependent upon

[1] Sahlgaard *v.* Kennedy (1880), 2 Fed. Rep. 295.

[2] Jackson *v.* Ludeling (1874), 21 Wall. 616, construing the Louisiana statute in regard to homologating a sheriff's sale.

[3] Graham *v.* Boston, Hartford, & Erie R. Co. (1883), 14 Fed. Rep. 753.

[4] Sahlgaard *v.* Kennedy (1882), 13 Fed. Rep. 242.

this suit is between citizens of the same State does not affect the right of the court to have exclusive jurisdiction of the ancillary proceedings. Thus, when a federal court has taken possession of property on the original bill, its jurisdiction in passing upon a cross-bill filed for complete relief in disposing of such property does not depend on the citizenship of the parties.[1]

The same principle is applicable to bills filed on the equity side of federal courts to restrain or regulate judgments at law, and thereby prevent injustice or an inequitable advantage under mesne or final process;[2] to suits to impeach, on the ground of fraud, a decree made in a former suit;[3] to subsequent foreclosure suits affecting the same property.[4]

So, also, where a federal court has taken control of a foreclosure suit, it may, without regard to the citizenship of the petitioners, assume jurisdiction of a suit to obtain a declaration of what was intended by the decrees and orders made in the former suit.[5]

[1] *In re* Tyler (1893), 149 U. S. 164, 181; s. c. 13 Sup. Ct. Rep. 785; Morgan's La. & Tex. R. & St. Ship Co. *v.* Texas Central R. Co. (1890), 137 U. S. 171, 201; s. c. 11 Sup. Ct. Rep. 61; First Nat. Bk. of Salem *v.* Salem Capital Flouring Mills Co. (1867), 12 Sawy. 485; s. c. 31 Fed. Rep. 580; Railroad Companies *v.* Chamberlain, 6 Wall. 748.

[2] Krippendorf *v.* Hyde (1883), 110 U. S. 276; Freeman *v.* Howe (1860), 24 How. 450. One reason advanced in the latter case (see above) for upholding the validity of the proceedings in the State court was that, as the parties were both citizens of Massachusetts, a different doctrine would leave them without remedy. This objection was shown to be futile, owing to the existence of the rule stated in the text.

[3] Foster *v.* Mansfield, C. & L. M. R. Co. (1888), 36 Fed. Rep. 627; Osborn *v.* Michigan Air Line R. Co. (1879), 2 Flip. 503.

[4] Carey *v.* Houston & Texas Central R. Co. (1892), 52 Fed. Rep. 671; s. c. 45 Fed. Rep. 438 (1891).

[5] Minnesota Co. *v.* St. Paul Co. (1864), 2 Wall. 609.

In this case the ancillary issue was raised by what was called a "supplemental bill" filed by one of the defendants. It was objected that this was a violation of the rules of equity pleading, and that the subject-matter of the suit and the new parties made by it were such as could not properly be brought before the court by a bill of that description. The court, however, said: "We think that the question is not whether the proceeding is supplemental and ancillary, or is independent and original, in the sense of the rules of equity pleading, but whether it is supplemental and ancillary, or is to be considered entirely new and original, in the sense which this court has sanctioned with reference to the line which divides the jurisdiction of the federal court from that of the State courts. No one, for instance, would hesitate to say that, according to the English chancery practice, a bill to enjoin a judgment at law is an original bill in the chancery sense of the word. Yet this court has decided many times that, when a bill is filed in the Circuit Court to enjoin a judgment of that court, it is not to be considered as an original bill, but as a continuation of the proceeding at law; so much so that the court will proceed in the injunction suit without actual service of subpœna on the defendant, and though he be a citizen of another State, if he were a party to the judgment at law. The case before us is analogous. An unjust advantage has been obtained by one party over another by a perversion and

In an ancillary suit a federal court has power to bring in, by compulsory process, any person claiming an interest in the property whose presence is necessary to the relief sought by the complainants, although such person does not himself seek the establishment of his interest in the suit, and his citizenship is such that it would defeat the jurisdiction of the court if the proceeding were an original one.[1]

§ 415. **Exclusiveness of Jurisdiction, how far affected by Territorial Limits.** — After a federal court in any one of the several districts over which a mortgaged railroad extends acquires jurisdiction of the property by the institution of a foreclosure suit, subsequent proceedings in another of the districts to subject the property for a different claim cannot oust the first court of its jurisdiction to proceed to a sale.[2]

If, however, it is a question of the jurisdiction of a State court over that part of a railroad which lies in another State, the exclusiveness of its control of litigation affecting that part depends upon whether the legislature of the latter State has assented to its exercising jurisdiction beyond the limits of the sovereignty from whom it derives its powers. Thus, although the consolidation of two railroad companies in adjoining States may have resulted in extinguishing the existence of one of the companies, the courts of the State to which the other company belongs are not necessarily invested with authority to entertain a jurisdiction *in rem*, as respects the property of the extinct company, unless the legislature has expressly so declared. The power of those courts to decree a sale of the property of the extinct company cannot be inferred merely from the fact that the consolidated company has been authorized to exercise its franchises within the limits of the other State.[3]

§ 416. **Rule that Equity acts in Personam applied so as to give Extra-territorial Jurisdiction.** — The rule that equity acts primarily *in personam* and not merely *in rem* is applied for the purpose of enabling a court of chancery to entertain jurisdiction of a bill for the foreclosure of a mortgage on property which lies outside as well as within the State where the suit is brought.[4]

abuse of the orders of the court, and the party injured comes now to the same court to have this abuse corrected, and to carry into effect the real intention and decree of the court, and that while the property which is the subject of contest is still within the control of the court and subject to its order."

[1] Compton *v.* Jesup (1895), 68 Fed. Rep. 263.

[2] Blackburn *v.* Selma, Marion, & Memphis R. Co. (1879), 2 Flip. 525.

[3] Eaton & Hamilton R. Co. *v.* Hunt *et al.* (1863), 20 Ind. 457.

[4] Mead *v.* New York, Housatonic, & Northern R. Co. (1877), 45 Conn. 199; s. c. 17 Am. Ry. Rep. 367.

A sale of a railroad as an entirety may be decreed not only in the court in which the original foreclosure suit was brought, but also in any of the other courts in which ancillary suits have been instituted.[1]

In such a case the court may require the defendant to execute to the receiver assignments of that part of the property which lies outside its territorial jurisdiction.[2]

A federal court of one of the States through which a railroad runs, having acquired jurisdiction of the subject-matter in an action of bondholders to foreclose the mortgage given by the railroad company upon all of its property in all the States, will not be ousted of its jurisdiction by a suit having been brought by the trustee in the State court of one of the other States for foreclosure on the property in that State.[3]

§ 417. **When Jurisdiction attaches.** — The rule as generally stated is that priority of jurisdiction is acquired by bringing of suit, the suit being for this purpose deemed to be brought when process is served,[4] and not when the petition and summons have merely been filed.[5]

If a case is removed to a federal court, its jurisdiction will relate back to the time of the original service of process.[6]

Where a suit to foreclose a trust mortgage executed by two corporations chartered in different States to secure bonds issued by them jointly is instituted in the district in which one of them is resident, and the resident corporation is served with process, while the non-resident one enters its appearance and answers jointly with the other, the decree rendered in the suit will be binding upon both.[7]

§ 418. **Jurisdiction not lost by Dismissal of Bill on Demurrer.** — After the dismissal of a bill on demurrer the jurisdiction of the court is not lost, as the case may be restored at any time before the end of the term. A second court, therefore, cannot, by taking

[1] Muller *v.* Dows (1876), 94 U. S. 444; Farmers' Loan & Trust Co. *v.* Chicago & A. Ry. Co. (1886), 27 Fed. Rep. 146.

[2] Union Trust Co. *v.* Olmsted (1886), 102 N. Y. 729; s. c. 7 N. E. Rep. 822; 26 Am. & Eng. R. R. Cas. 61; Northern Ind. R. Co. *v.* Michigan Central R. Co. (1853), 15 How. 233, 243; Wilmer *v.* Atlanta & Richmond Air Line, etc. R. Co. (1874), 2 Woods, 409 (citing several cases as to extra-territorial jurisdiction obtained by acting *in personam*); Rothschild *v.* Rochester, etc. R. Co. (Penn. Comm. Pl., 1887), 1 Ry. & Corp. L. J. 321.

[3] Woodbury *et al.* *v.* Allegheny & K. R. Co. *et al.* (1895), 72 Fed. Rep. 371.

[4] Owens *v.* Ohio Central R. Co. (1884), 20 Fed. Rep. 10, 13; Union Mut. Life Ins. Co. *v.* University of Chicago (1881), 6 Fed. Rep. 443; Chittenden *v.* Brewster (1864), 2 Wall. 191, 197.

[5] Bell *v.* Ohio Life & Trust Co. (1858), 1 Biss. 260.

[6] Owens *v.* Ohio Central R. Co. (1884), 20 Fed. Rep. 10.

[7] Wilmer *v.* Atlanta & Richmond Air Line R. Co. (1875), 2 Woods, 447.

jurisdiction of the case during the interval between such dismissal and restoration, oust the first from its control of the proceedings.[1]

§ 419. **What Possession is necessary to give a Court Control of the Res as against a Co-ordinate Tribunal.** — This is a question which the authorities leave in an embarrassing state of uncertainty. Some judges have held that the constructive possession which is obtained by commencing an action of which possession of the *res* is a necessary incident will prevail against an actual seizure under a later service of process. Other judges take the contrary view, not merely when the proceedings are not, technically speaking, *in rem*, but also when they are at least in the nature of such proceedings, — as, for example, to charge property with a lien. To formulate a general rule under these circumstances is out of the question, and it is deemed sufficient to exhibit the actual result of the cases in the subjoined note.[2]

[1] Union Trust Co. *v.* Rockford, R. I. & St. Louis R. Co. (1874), 6 Biss. 197.

[2] In Union Trust Co. *v.* Rockford, R. I. & St. L. R. Co. (1874), 6 Biss. 197, Judge Blodgett used the following language: "It will hardly be necessary to cite authorities to show that it is, and has long been, the settled rule of law in all cases of conflict of jurisdiction that the court which first takes cognizance of the controversy is entitled to retain jurisdiction to the end of the litigation, and incidentally to take possession of or control the *res*, the subject-matter of the dispute, to the exclusion of all interference from other courts of co-ordinate jurisdiction. The proper application of this rule does not require that the court shall also first take by its officers possession of the thing in controversy, if tangible and susceptible of seizure, for such a trifle would only lead to unseemly haste on the part of officers to get the manual possession of the property; and, while the court first appealed to was investigating the rights of the respective parties, another court, acting with more haste, might by a seizure of the property make the first suit wholly unavailable. To avoid such a result, the broad rule is laid down that the court first invoked will not be interfered with by another court while the jurisdiction is retained." In another case decided about the same time (Wilmer *v.* Atlanta & Richmond Air Line R. Co. (1874), 2 Woods, 409), Judge Woods considered that, after service on the railroad company of a subpœna and a restraining order, enjoining it from delivering possession of the trust property to any one except a receiver appointed by the federal Circuit Court, possession taken by a State court under color of process served in a suit subsequently commenced was a contempt of the jurisdiction of the Circuit Court, even though the State court first obtained actual possession of the property. The jurisdiction of a court was declared not to be dependent on actual seizure of the property. Constructive possession was obtained by the subpœna and the restraining order, and the property was thereafter *in gremio legis*. The receiver appointed by Judge Woods being unable to obtain possession of the part of the property situated in Georgia, owing to the fact that one of the State courts had appointed a receiver and taken actual possession in a suit subsequently commenced, applied for a writ of assistance. The application was heard by Circuit Justice Bradley and District Judge Erskine, and denied. The learned circuit justice said that the test was not which action was first commenced, nor which cause of action had priority, but which court first acquired jurisdiction over the property. If the State court had power to take possession when it did so, and did not

§ 420. **Who may assert the Exclusiveness of the Jurisdiction of the Court which first acquires Control.** — It is only by those who are clothed with the authority of the first court to assert the priority

invade the possession or jurisdiction of the federal court, the possession of the former would not be interfered with. That the State court had such power was the conclusion arrived at. "Service of process," it was said, gives jurisdiction over the person. Seizure gives jurisdiction over the property; and until it is seized, no matter when the suit was commenced, the court does not have jurisdiction. . . . A bill to foreclose is a personal proceeding, although it has reference to a specific thing. Its object is to put an end to an existing equity, and to procure a sale of the mortgaged premises. Possession may be taken in the course of the proceedings, but, until it is taken, can it be said that the property is sacred from the touch of other persons or courts?" Virtually, therefore, the doctrine of the learned justice is that there is no such thing as constructive possession of the *res*, at least in a personal proceeding. The authority of this ruling, however, is very seriously impaired by the fact that it seems to be based mainly on the hypothesis that foreclosure is a proceeding *in personam only* for all intents and purposes, a position which is by no means beyond dispute. In Day *v.* Micou (1873), 18 Wall. 156, 160, it was laid down that proceedings to foreclose a mortgage are *quasi* proceedings, *in rem* at least. In Guaranty Trust & Safe Deposit Co. *v.* Green Cove Springs & Melrose R. Co. (1891), 139 U. S. 137; s. c. 11 Sup. Ct. Rep. 512, the same court was confronted with an argument of counsel based on the assumption that a proceeding to foreclose a trust deed was a proceeding *in rem*, and though it declined to accept the inferences sought to be drawn from that assumption, it did not cast any doubt on the assumption itself. And such seems to be the more general view which the courts take of a foreclosure suit, at all events where, as is commonly the case, an order of sale is asked for. See Waples Proceedings in Rem, §§ 607 *et seq.*, where it is pointed out that such a suit is one of a dual aspect.

The distinction drawn by Justice Bradley as to the effect of the service of process in proceedings *in rem* and proceedings *in personam* seems to be ignored in a late case in the Circuit Court of Appeals, Compton *v.* Jesup (1895), 68 Fed. Rep. 263. There it was held that a proceeding in a State court by the holder of an equipment bond to subject a portion of a railroad system to his lien, although it might be a proceeding *in rem*, did not involve the actual seizure of the property, and therefore did not prevent a federal court from taking possession of the property in a suit to foreclose all the liens on the entire property. The court lays down the broad rule that "mere constructive possession is not enough to exclude the possession of another court," thus putting into formal words the principle upon which Justice Bradley's opinion was founded. But this theory is opposed to the opinion of the Supreme Court of the United States in Buck *v.* Colbath (1865), 3 Wall. 334, where the sufficiency of constructive possession is recognized, to say nothing of the opinions of Judges Blodgett and Woods, referred to above. Unfortunately the Supreme Court of the United States has not, so far as we have been able to ascertain, stated precisely what it understands by "constructive" possession, the use of the term being merely *obiter* in the case just cited. The principle laid down by that court in the late case of Heidritter *v.* Elizabeth Oil Cloth Co. (1884), 112 U. S. 294; s. c. 5 Sup. Ct. Rep. 135, that when the object of the action requires the control and dominion of the property involved in the litigation, that court which first acquires possession, *or that dominion which is equivalent to possession*, draws to itself the exclusive right to dispose of it for the purpose of its jurisdiction, is expressed in terms too vague to indicate precisely what view would be adopted by the most authoritative tribunal in the country, if the question under discussion were to come before it. The case in question was one of actual possession, and its relevancy therefore lies principally in the fact that, although the theory of Justice Bradley and

and exclusiveness of its jurisdiction that an objection to the jurisdiction of the second court, founded on possession and control of the subject-matter, can be raised.[1]

§ 421. **Procedure and Practice.** — Objections to the jurisdiction of a court must be addressed to the court itself, and cannot be raised in a co-ordinate court.[2]

Such objections must be submitted by a plea in abatement. A demurrer for want of equity or an answer is a voluntary appearance, although the demurrer may also seek to aver a want of jurisdiction.[3]

It is too late to raise such objections after the defendant's answer is filed, whether replication is put in or not,[4] and still more is this true after a trial on the merits.[5]

the Court of Appeals that the constructive possession which is obtained by service of process is not, as against actual possession, enough to invest a court with exclusive control of the *res* may be correct, this principle does not hold with all kinds of constructive possession.

The case of Union Trust Co. *v.* Rockford, R. I. & St. L. R. Co. (1874), *supra*, was approved in Owens *v.* Ohio Central R. Co. (1884), 20 Fed. Rep. 13, but the ruling of Justice Bradley apparently was not brought to the attention of the court. That ruling has, however, been expressly disapproved in May *v.* Printup, 59 Ga. 128.

As bearing upon the question, it may also be noted that in a recent case in Tennessee also the court denied that an attachment on railroad property, after the court has taken charge of it in insolvency proceedings, gives any lien, though the receiver has not yet taken actual manual caption of it. McDonald *v.* Charleston, C. & C. R. Co. (1893), 93 Tenn. 281; s. c. 24 S. W. 252.

Whatever may be the proper technical designation of a foreclosure suit, there would seem to be two unanswerable reasons why the view set forth in the passage cited at the beginning of this note should prevail. The first is the one forcibly stated by Judge Blodgett. The second is that it is a highly anomalous position to maintain that a suit in which the court cannot give effect to its decrees without the possession of the *res*, and in which the commencement of the proceedings is undoubtedly intended to operate as a notification to all the world that the court has assumed the control of the subject-matter, should be endered virtually nugatory because another court and another litigant have used somewhat more physical activity. If comity between courts is to have any practical results at all, it should certainly be an obstacle to interference in such a case. The only consideration which can justify co-ordinate tribunals in undertaking to nullify the action of each other is that the cause of abstract justice will thereby be subserved. In the absence of such a reason, we think, all the subsequent litigation should be conducted in the court which, in a liberal sense of the phrase, first acquires possession of the *res*.

[1] Forrest's Exrs. *v.* Luddington (1880), 68 Ala. 1; s. c. 12 Am. & Eng. R. R. Cas. 330.

[2] Freeman *v.* Howe (1860), 24 How. 450; Alabama & Chattanooga R. Co. *v.* Jones (1872), 7 N. B. R. 145.

[3] Blackburn *v.* Selma, M. & M. R. Co. (1879), 2 Flip. 525; s. c. 3 Fed. Cas. 526, Case No. 1467. See, however, Dan. Ch. Pl. 555, where it is said that a demurrer may in some cases be a proper way of objecting to the jurisdiction.

[4] Turner *v.* Indianapolis, B. & W. R. Co. (1878), 8 Biss. 380; s. c. 26 Fed. Cas. 367, Case No. 14,259.

[5] Gilman *v.* Perkins (1881), 7 Fed. Rep. 887.

Where attachments have been levied on the property of a foreign corporation, and a receiver is afterwards appointed in the State where the corporation was organized, he cannot plead to or defend the attachment suits without first applying to the courts where they are pending, and becoming a party thereto.[1]

Article II. — To what Extent the Pendency of a Suit in one Court is a Bar to a Suit in another.

§ 422. **Introductory.** — It has been shown above that between courts of concurrent jurisdiction the rule is applicable, and that the one which has first obtained jurisdiction in a given case must retain it exclusively until it is finally disposed of. Different principles prevail where the mere pendency of a prior suit is set up to defeat a second one. "It is the interference with the possession of another court which would ensue that prevents taking jurisdiction in one class of cases, and the pendency of the same identical controversy in another court of concurrent jurisdiction that prevents it in the other."[2]

A court of equity, having jurisdiction of the subject-matter in a foreclosure suit on a second mortgage to which the trustee of a first mortgage is a party defendant, with all others interested, will not allow the filing of an independent bill to foreclose the first mortgage, asking no special relief against parties in interest, inasmuch as there can be a decree relating to and adjusting the rights of all the other parties in the action of the trustee of the second mortgage.[3]

A full discussion of the numerous decisions on this subject would of course be out of place in this volume. The reader will find ample materials for investigation by referring to the authorities cited in Bennett on Lis Pendens, §§ 343 *et seq.*, and in the note to Cook *v.* Burley, 11 Wall. 659, in the Lawyer's Co-operative edition. See also the list of cases cited in the opinions in Lathan *v.* Chaffee (1881), 7 Fed. Rep. 520, and Stanton *v.* Embrey (1877), 93 U. S. 548, 554. It will be sufficient to state the general doctrine and the exceptions thereto, citing as authorities only cases involving corporate securities, and such others as may be necessary for the sake of clearness.

[1] South Carolina R. Co. *v.* People's Sav. Institution (1879), 64 Ga. 18; s. c. 12 Am. & Eng. R. R. Cas. 432.

[2] Andrews *v.* Smith (1881), 5 Fed. Rep. 833, per Wheeler, D. J.

[3] Mercantile Trust Co. *v.* Atlantic & Pac. R. Co. *et al.* (1895), 70 Fed. Rep. 528. See Morgan's La. & Tex. R. & St. Ship Co. *v.* Texas Central Ry. Co. (1890), 137 U. S. 171, 201; s. c. 11 Sup. Ct. Rep. 61.

§ 423. **Suit not barred by Pendency of a Prior Suit in a Foreign Jurisdiction.** — It is well settled that the plea of the pendency of a suit in a foreign jurisdiction will not abate a suit in a domestic tribunal, though the prior suit is for the same cause of action, and between the same parties.[1]

For the purposes of this rule the different States in the Union are considered to be foreign to each other.[2]

And the same relation undoubtedly prevails between State courts and federal courts not exercising jurisdiction over the same territory.[3]

But whether the pendency of a suit in a federal court in a given district be successfully pleaded to the further prosecution of a like suit in a State court in the same district is a question as to which there has been some conflict of opinion. It has been said to be now well settled that this is not a good plea.[4]

§ 424. **Plea of Lis Pendens not sustainable, unless there is an Identity between the two Suits.** — Whether the courts in which the two suits are brought are foreign to each other in the sense that they exercise jurisdiction over a different territory, or only foreign in the sense that they derive their powers from different sovereignties, as is the case with the Federal and State courts, a second suit will in no event be abated because a prior one dealing with the same subject-matter is pending, unless the *cases* are the same.

There must be the same parties, or at least such as represent the same interest, there must be the same rights asserted and the same relief prayed for. This relief must be founded in the same facts, and the title or essential basis of the relief sought must be the same. The identity in these particulars should be such that if the pending case had already been disposed of, it could be

[1] Insurance Co. *v.* Brune's Assignee (1877), 96 U. S. 588; Stanton *v.* Embrey (1877), 93 U. S. 548; Eaton & Hamilton R. Co. *v.* Hunt (1863), 20 Ind. 457; South Carolina R. Co. *v.* People's Sav. Ins. (1879), 64 Ga. 18; s. c. 12 Am. & Eng. R. R. Cas. 432.

[2] Bennett on Lis Pendens, § 348 and cases cited.

[3] Stanton *v.* Embrey (1877), 93 U. S. 548; Bennett on Lis Pendens, §§ 379, 380; Forrest's Exrs. *v.* Luddington (1880), 68 Ala. 1; s. c. 12 Am. & Eng. R. R. Cas. 330; South Carolina R. Co. *v.* People's Sav. Institution (1879), 64 Ga. 18; s. c. 12 Am. & Eng. R. R. Cas. 432.

[4] Rule so stated by Judge Wheeler in Dwight *v.* Central Vermont R. Co. (1881), 9 Fed. Rep. 785, modifying his former opinion, as stated in Mercantile Trust Co. *v.* Lamoille Valley R. Co. (1879), 16 Blatch. 324, and Andrews *v.* Smith (1881), 5 Fed. Rep. 833, and relying on the authority of Gordon *v.* Gilfoil, 99 U. S. 168, and Latham *v.* Chaffee (1881), 7 Fed. Rep. 520.

Mr. Bennett, in his treatise on Lis Pendens (§§ 381, 382), lays down a contrary rule on the authority of Smith *v.* Atlantic Mut. Fire Ins. Co. (1850), 22 (2 Fost.) N. H. 21; but although there is some lack of distinctness in the language of the courts, the doctrine of the later cases is opposed to this view.

pleaded in bar as a former adjudication of the same matter between the same parties.[1]

§ 425. **Second Suit not barred if Parties are different.** — If the parties in the second suit are different from those in the first, the court applied to will not abate the suit merely because a co-ordinate court has already assumed jurisdiction of the subject-matter.[2]

Thus a suit for an accounting in a federal court between the bondholders and their trustees will not be abated for the reason that there is pending in a State court a similar suit in regard to the same subject-matter, and for the same relief, between the trustees and other persons.[3]

So where a railroad company is sued by a few minority stockholders who ask for a receiver, the suit being opposed by the great majority of the stockholders, the court may properly entertain a petition of the bondholders for foreclosure, and the appointment of a receiver of their own selection. Bondholders whose interest is not being paid cannot be stayed in proceedings to enforce their lien until a battle between the stockholders is fought out, nor can they be compelled to obtain their relief by intervening in the stockholders' suit.[4]

Although the trustees represent the bondholders for most purposes in respect to litigation for the enforcement of the securities, the bondholders are not deemed to be parties to a foreclosure suit, brought by the trustees in a State court, in such a sense that they are debarred from seeking the same remedy in their own names in a federal court. Therefore, in the absence of some restriction in the deed of trust upon the right of coupon-holders, with the assent of a majority of bondholders, to foreclose for default in interest, one of those coupon-holders may maintain a suit for such default in a federal court, though a suit for the same purpose has been instituted by the trustees in the State court.[5]

A fortiori, where the character of the trust is such that a foreclosure suit cannot be instituted by the trustees without joining some of the bondholders, and some of them have been accordingly made parties in a suit brought in a State court, the pendency of

[1] Watson *v.* Jones (1871), 13 Wall. 679; Hay *v.* Alexandria & Washington R. Co. (1882), 4 Hughes, 331. See also the cases reviewed in Latham *v.* Chaffee (1881), 7 Fed. Rep. 520.

[2] Shelby *v.* Bacon (1850), 10 How. 56.

[3] Andrews *v.* Smith (1881), 5 Fed. Rep. 833.

[4] Pennsylvania Company for Insurance on Lives and Granting Annuities *v.* Jacksonville, J. & K. W. R. Co. (American Construction Co., Intervener), (1893), C. C. A. 55 Fed. Rep. 131.

[5] Mercantile Trust Co. *v.* Lamoille Valley R. Co. (1879), 16 Blatch. 324; Beekman *v.* Hudson River West Shore R. Co. (1888), 35 Fed. Rep. 3.

that suit will be no bar to another suit in a federal court for the foreclosure of the mortgage and the removal of the trustees. The trustees under such circumstances do not represent the entire body of the bondholders.[1]

§ 426. **Prior Suit not a Bar where Different Relief is asked for.** — If the relief asked in the second suit is materially different from or more comprehensive and extended than that asked in the first, the pendency of the first suit is not a bar to the second lien in the same court.[2]

Thus, a party having notes secured by a mortgage may, unless restrained by statute, sue in a court of chancery to foreclose his mortgage, and in a court of law to recover a judgment on his notes, and in another court of law, in an action of ejectment for possession of the land.[3]

A suit in a State court which is essentially one for foreclosure is not a bar to another in a federal court in the same district, the object of which is to maintain the right to the road independently of the right to redeem.[4]

What is essentially a general creditors' bill is not barred in a federal court by a pending suit of any less scope in a State court, and therefore not by a suit which does not aim at marshalling all the creditors and their claims, and ascertaining all liens and their priorities.[5]

The trustee of a first mortgage upon a portion of the road cannot plead the pendency of a foreclosure suit brought by him in a federal court in bar of a foreclosure suit in a State court against him and others, by trustees of a subsequent mortgage covering the entire property of the mortgagor.[6]

A suit filed by a contractor to have a judgment for the sum due to him for building parts of the road declared a first lien thereon, and also for an accounting and for foreclosure of certain trust mortgages executed by the company, is not a bar to a subsequent suit by the trustee to foreclose the same mortgages. Here, although the original complaint has asked for foreclosure, no such relief can be given unless on the application of the trustees or the bondholders whom he represents.[7]

[1] Brooks *v.* Vermont Central R. Co. (1878), 14 Blatch. 463.

[2] Massachusetts Mut. Life Ins. Co. *v.* Chicago & A. R. Co. (1882), 13 Fed. Rep. 857, 860.

[3] Buck *v.* Colbath (1865), 3 Wall. 334. See chapter on remedies.

[4] Dwight *v.* Central Vermont R. Co. (1881), 9 Fed. Rep. 785.

[5] Hay *v.* Alexandria & Washington R. Co. (1882), 4 Hughes, 331.

[6] Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467.

[7] American Loan & Trust Co. *v.* East & West R. Co. (1889), 37 Fed. Rep. 242.

So a bill filed in behalf of the holder of certain corporation bonds secured by a trust mortgage, alleging the refusal of the trustee to proceed under the mortgage according to its provisions, and a misappropriation by the defendant of the tolls and revenues mortgaged, will not be dismissed because a bill to which such trustees were made parties had been previously filed in the State court to define the priorities of the various lien creditors of the corporation.[1]

The converse of this principle also holds good. Thus the prior jurisdiction acquired by the pendency of a former action in which an injunction and receivership are sought will exclude the interference of the court in another suit of which the principal object is the same original remedies.[2]

§ 427. **Second Suit allowed to proceed sometimes.** — The fact that the later suit is best calculated to lead to a decision on the merits is sometimes a sufficient reason for allowing it to proceed, in spite of the fact that the earlier suit is for the same cause of action and comprehends the same parties.[3]

Where a trustee for bondholders is attempting to foreclose a mortgage upon bonds and subject the property thereto, which are not valid debts against a corporation, such action would be in hostility to a holder of valid bonds; and in such a case the remedy by foreclosure is not exclusive in the trustee, but may be pursued by the holder beneficially interested in the bonds.[4]

A decree of foreclosure which declares all the bonds due where it appears in the case of some of the bonds the bondholders had accepted interest after the limit of time in which a default in interest entitled them to declare the principal of their bonds due had expired, and thereby waived the default, will be reversed.[5]

[1] Stewart *v.* Chesapeake & Ohio Canal Co. (1880), 1 Fed. Rep. 361.

[2] Young *v.* Rollins (1881), 85 N. C. 485; s. c. 12 Am. & Eng. R. R. Cas. 455.

[3] Cheever *v.* Rutland & Burlington R. Co. (1869), 4 Am. Ry. Rep. 291. There the trustees under three successive mortgages of the property of a railway corporation filed a bill in equity against the corporation to settle and establish the powers and duties of each other and towards the corporation in respect to the title, possession, and control of the property, and a decree was made in accordance with the prayer of the bill, but was never completely executed. Held, that the fact that this suit was technically pending did not defeat a suit brought many years afterwards by the trustees under the first mortgage to enforce their security as against the second-mortgage interest. The circumstances that many of the parties to the former suit were dead, that the former decree was dormant, and that it was repudiated by the second-mortgage interests as a fraud upon them, rendered proper an original bill setting forth the original cause of action, as well as the suit and decree therein.

[4] Farmers' & Mechanics' Nat. Bank *v.* Waco Electric Ry. & Light Co. (Tex. Civ. App.), 36 S. W. Rep. 131 (1896).

[5] Ala. & Ga. Manufg. Co. *et al.* *v.* Robinson, 56 Fed. Rep. 690; s. c. 6 C. C. A. 80, 13 U. S. App. 359 (1893).

CHAPTER XXII.

CITIZENSHIP AND REMOVAL OF CAUSES.

ARTICLE I. — CITIZENSHIP OF CORPORATIONS.[1]

§ 428. **Introductory.** — Questions relating to the citizenship of corporations frequently arise in suits upon railroad securities. A short review of some of the decisions in such suits will therefore be useful to the practitioner in connection with the other subjects treated in this book.

§ 429. **A Corporation is for Jurisdictional Purposes a Citizen of the State under whose Laws it was organized.** — The theory is that although a corporation cannot be a citizen of any State in the sense in which the word is used in the United States Constitution, and a suit against a corporation in a federal court is regarded as a suit against its stockholders, it is conclusively presumed, by a legal fiction, that all the stockholders are citizens of the State which created the corporation.[2]

[1] A useful article on this subject will be found in 13 Centr. L. J. 482.

[2] Louisville, Cincinnati, & Charleston R. Co. *v.* Letson (1844), 2 How. 497; Marshall *v.* Baltimore & Ohio R. Co. (1853), 16 How. 314; Railway Co. *v.* Whitton

From this doctrine it follows that, although two or more railroad companies in different States may unite under the laws of those States for the purpose of forming a single consolidated company, the existence of the constituent corporations still continues, so far as the jurisdiction of the Federal and State courts is concerned. In other words, the consolidated company is, for the purposes of suits instituted against it in any one of the States, deemed to be a citizen of such State. Hence a company thus formed cannot remove a cause to the federal courts if sued in one of the States by a citizen of that State; [1] and if a citizen of one of the States sues it in another of those States, the suit may be removed to a federal court.[2]

Though a corporation of one State be incorporated by the legislature of another as a corporation of the latter, it continues a citizen of the State of its original corporation, so as to give jurisdiction to a federal court as between citizens of different States in an action by it; for instance, to cancel a guaranty of bonds in the hands of a citizen of the second State incorporating it.[3]

The effect of the doctrine that a corporation is a citizen of the State where it was organized, and of the rule that the federal courts have jurisdiction only of suits between citizens of different States, is that, on a bill of foreclosure by citizens of one State against a railroad corporation of another State, in the United States court, for the latter State, bondholders who are citizens of the State where the suit is brought cannot be made co-plaintiffs.[4]

§ 430. **Citizenship of Corporations carrying on Business in States other than that in which they were organized.** — If a foreign corporation is carrying on business in a sister State, the question whether it is a citizen of that State so as to render it incapable of removing a suit brought against it from the State courts to the federal courts is one of legislative intent. If the rights conferred

(1871), 13 Wall. 270; Ohio & Mississippi R. Co. *v.* Wheeler (1861), 1 Black, 286; Muller *v.* Dows (1876), 94 U. S. 444; Myers *v.* Dorr (1870), 13 Blatch. 22; Baltimore & Ohio R. Co. *v.* Cary (1876), 28 Ohio St. 208; Union Trust Co. *v.* Rochester & Pittsburg R. Co. (1886), 29 Fed. Rep. 609.

[1] Johnson *v.* Philadelphia, Wilmington, & Baltimore R. Co. (1881), 9 Fed. Rep. 6.

[2] Railway Co. *v.* Whitton's Admr. (1871), 13 Wall. 270; Muller *v.* Dows (1876), 94 U. S. 444.

[3] Louisville Trust Co. *et al.* *v.* Louisville, N. A. & C. R. Co. (1896), 75 Fed. Rep. 433, upon authority of Nashua & Lowell R. Corp. *v.* Boston & Lowell R. Corp. (1890), 136 U. S. 356; s. c. 10 Sup. Ct. Rep. 1004; Newport & Cincinnati Bridge Co. *v.* Woolley (1880), 78 Ky. 523; St. Louis & San Francisco R. Co. *v.* James (1896), 161 U. S. 545; s. c. 16 Sup. Ct. Rep. 621.

[4] Jackson & Sharp Mfg. Co. *v.* Burlington & Lamoille R. Co. (1887), 24 Blatch. 194; s. c. 29 Fed. Rep. 474.

amount to a mere license to do business in the State, it retains its jurisdictional privileges as a foreign corporation, and may remove a suit brought against it.[1] Nor does a statute permitting a foreign corporation to extend its road into a State, and conferring upon it, for the purpose of enabling it to operate that extension, such powers as have been conferred upon it by the State where it was created, make it a corporation of the second State.[2] Nor does a corporation, by merely leasing, possessing, and operating in another State the property of a corporation chartered in that State, become a citizen thereof.[3] Nor will the intent to create a new corporation be presumed from an act, for instance, which grants in Tennessee to a specific company, "incorporated by the legislature of Kentucky," a right of way, and invests it with all the rights, powers, and privileges, and subjects it to all the restrictions and liabilities, prescribed in its original charter. This conclusion will not be rebutted by the fact that the statute contains other sections which are in form designed to make alterations in and additions to that charter, provided their actual effect is merely to lay down the conditions upon which the corporation is to be allowed to exercise its powers.[4]

[1] Railroad Co. *v.* Harris (1870), 12 Wall. 65. In this case the Baltimore & Ohio R. Co., a corporation chartered in Maryland, was granted the right to extend its road into Virginia by an act which granted to the company in Virginia the same rights and privileges, and subjected it to the same pains, penalties, and obligations, as had been granted and imposed by the original Maryland enactment, and reserved to the State of Virginia and her citizens the same rights, privileges, and immunities as had been reserved to the State of Maryland and her citizens. The court said: "The permission was broad and comprehensive in its scope, but it was a license and nothing more. It was given to the Maryland corporation as such, and that body was the same, in all its elements and in its identity, afterwards as before. In its name, locality, capital stock, the election and power of its officers, in the mode of declaring dividends, and doing all its business, its unity was unchanged. Only the sphere of its operations was enlarged." The rulings in Balt. & Ohio R. Co. *v.* Gallahue's Admrs. (1855), 12 Gratt. 655, 658; Goshorn *v.* Supervisors (1865), 1 W. Va. 308; and Railroad Co. *v.* Supervisors (1869), 3 W. Va. 319, were concurred with as to the point that this corporation was suable in Virginia and West Virginia, that position not being at all inconsistent with the right of removing the suit after its commencement. Railroad Co. *v.* Harris was followed in Railroad Co. *v.* Koontz (1881), 104 U. S. 5; Goodlett *v.* Louisville & Nashville R. Co. (1887), 122 U. S. 391; County Court *v.* Baltimore & Ohio R. Co. (1888), 35 Fed. Rep. 161.

[2] Pennsylvania R. Co. *v.* St. Louis, Alton, & T. H. R. Co. (1886), 118 U. S. 290.

[3] Balt. & Ohio R. Co. *v.* Cary (1876), 28 Ohio, 208; s. c. 14 Am. Ry. Rep. 97; Williams *v.* Missouri, K. & T. R. Co. (1875), 3 Dill. 267; Lathrop *v.* Union Pac. R. Co. (1873), 1 Macarthur (D. C.) 234. Compare South Carolina R. Co. *v.* People's Savings Ins. (1879), 64 Ga. 18, where it was held that a mere permission to extend a road into a State does not change the *status* of the company as a foreign corporation, so as to exempt its property from the attachment allowed by State laws on the property of non-residents.

[4] Goodlett *v.* Louisville & Nashville R. Co. (1887), 122 U. S. 391.

On the other hand, if the original charter is duplicated, and the legislation assumes the form of creating a new corporation, the effect will be to make the foreign corporation a citizen of the State.[1]

So also an intent to create a new corporation is manifested by the provision of a statute which grants to a foreign corporation a right of way for the construction of a railroad with which any railroad company chartered or to be chartered in the State shall have the right to connect its road, and requires it to construct a branch railroad in the State, to open books for subscriptions of stock to a certain amount in the State, to apply the money so subscribed to the construction of the road within the State, and to hold elections in the State. Such a construction of the statute receives confirmation from the fact that it is followed by other statutes, each speaking of the company as being "incorporated" by the legislature of the State.[2]

When incorporation in a foreign State is obtainable by a compliance with certain formalities prescribed by a general law, an act which *prima facie* shows an intention on the part of a company to take advantage of the law may not be conclusive as to its *status*. Thus the mere filing of a certificate of organization in a foreign State by some of the stockholders, the purpose of which seems to be only the preservation of certain rights formerly granted by that State to the company, which has been succeeded by the reorganized corporation to which those stockholders belong, and which is not followed by any acts, such as the election of officers, which would indicate the intention of the company to recognize the existence of the new company in the second State, will not have the effect of constituting the reorganized corporation a corporation in that State.[3]

But a corporation chartered by statute in a State doing business there, and dealing as if organized, by reciting in its bonds and mortgage that it has been chartered by that State, is estopped, when sued in the federal court, to deny that it was only organized under the laws of that State.[4]

[1] Blackburn *v.* Selma, M. & M. R. Co. (1879), 2 Flip. 525; s. c. 3 Fed. Cas. 526, Case No. 1467; Henen's Admr. *v.* Balt. & Ohio R. Co. (1881), 17 W. Va. 881; Washington, Alexandria, & Georgetown R. Co. *v.* Alexandria & Washington R. Co. (1870), 19 Gratt. 592.

[2] Memphis & Charleston R. Co. *v.* Alabama (1882), 107 U. S. 581.

[3] Pennsylvania R. Co. *v.* St. Louis, Alton, & T. H. R. Co. (1886), 118 U. S. 290.

[4] Blackburn *v.* Selma, M. & M. R. Co. (1879), 2 Flip. 525; citing Zabriskie *v.* Cleveland, Columbus, & Cincinnati R. Co. (1859), 23 How. 381.

§ 431. **Corporation suable in Sister State.** — A foreign corporation, though not adopted by the sister State, is suable there if it has impliedly[1] or expressly[2] consented to be sued there in consideration of its being permitted by the legislature to exercise its corporate powers and privileges within the State.

Under such circumstances a foreign corporation is, for the purposes of suit in a federal court, deemed to be "an inhabitant of" and "found within" the district corresponding to the sister State, under the provisions of the act of Congress regulating the service of process.[3]

But a foreign construction company will not be allowed to maintain a bill in equity against a foreign railroad corporation and a citizen of the State where suit is brought, to enforce specific performance of a covenant in a contract for the delivery of bonds and certificates of stock in payment of work to be performed by the construction company in a foreign State, although the railroad corporation has appeared by attorney and has an office in the State where suit is brought for the transfer of shares of its capital stock. "The determination of the question" (said the court), "who shall be entitled to receive from the corporation certificates of its stock so that they shall thereby become members of it, is one which does not alone affect the external relations of the corporation but involves its organic laws, which are necessarily local and require local administration."[4]

If the express condition on which the foreign corporation is to be permitted to do business in the sister State is that it shall have an agent there upon whom a valid service of process may be made, the corporation may be sued either in the Federal or State courts.[5]

If the suit is one to subject to liens railroad property which lies wholly within the district in which the suit is brought, the suit will not be defeated by the fact that non-residents are joined with the railroad company as defendants, for such a case comes within the provisions of the act of Congress permitting service to be

[1] Railroad Co. *v.* Harris (1870), 12 Wall. 65; Blackburn *v.* Selma, M. & M. R. Co. (1879), 2 Flip. 525.

[2] *Ex parte* Schollenberger (1877), 96 U. S. 369.

[3] *Ex parte* Schollenberger (1877), 96 U. S. 369; Hayden *v.* Androscoggin Mills (1879), 1 Fed. Rep. 93; Riddle *v.* New York, L. E. & W. R. Co. (1889), 39 Fed. Rep. 290.

[4] Kansas & Eastern Railroad Construction Co. *v.* Topeka, Salina, & Western R. Co. (1883), 135 Mass. 34; s. c. 16 Am. & Eng. R. R. Cas. 495.

[5] *Ex parte* Schollenberger (1877), 96 U. S. 369; Runkle *v.* Lamar Insurance Co. (1880), 2 Fed. Rep. 9. In the former case the earlier decisions to the contrary effect in Day *v.* Newark Mfg. Co. (1850), 1 Blatch. 628, and Pomeroy *v.* New York & New Haven R. Co. (1857), 4 Blatch. 120, were overruled.

made by publication; and if it has been duly made in the manner prescribed, a plea to the jurisdiction is not sustainable.[1]

A foreign corporation, by filing an answer, waives the right to be sued only in the federal district of the State creating it, and if the suit be in equity to enforce a lien or claim to property within the federal district, the jurisdiction of the court is not limited to the property situated therein, but is plenary for all proper purposes after such voluntary appearance.[2]

Article II. — Removal of Causes.[3]

§ 432. **There can be no Removal of a Cause unless the Right to remove it exists when Suit has begun.** — In several cases it has been held that a suit may be removed if the necessary conditions of diverse citizenship exist when the petition for removal is filed, and that the citizenship of the parties at the commencement of the suit is immaterial.[4]

But the Supreme Court of the United States has settled the question the other way, by holding that both under the Judiciary Act of 1789 [5] and the act of 1875 [6] there can be no right of removal unless the requisite citizenship existed both at the time when suit was begun and when the petition for removal is filed.

§ 433. **State Legislation cannot affect the Right of Removal.** — Hence a statute is void which denies a foreign corporation the privilege of transacting business within a State, unless on the condition of agreeing that it will not remove any suit commenced against it by a citizen of the State into the Federal courts.[7]

So also a provision in a statute that the leasing, purchasing, or

[1] Hay *v.* Alex. & Washington R. Co. (1882), 4 Hughes, 331. In that case there was an additional circumstance to support the jurisdiction of the court, viz. that the validity of the liens in question depended upon the construction of a law of the United States, the question being whether a guaranty of bonds by the District of Columbia was *ultra vires* or not.

[2] Blackburn *v.* Selma, M. & M. R. Co. (1879), 2 Flip. 525.

[3] For a more detailed review of this subject the practitioner will, of course, refer to other treatises.

[4] McLean *v.* St. Paul & Chicago R. Co. (1870), 16 Blatch. 309; Chicago, St. Louis, & New Orleans R. Co. *v.* McComb (1879), 17 Blatch. 371; Jackson *v.* Mutual Life Ins. Co. (1878), 3 Woods, 413, 417; Curtin *v.* Decker (1881), 5 Fed. Rep. 385, 386; Jackson *v.* Mutual Life Ins. Co. (1878), 60 Ga. 427.

[5] Insurance Co. *v.* Pechner (1877), 95 U. S. 183.

[6] Gibson *v.* Bruce (1883), 108 U. S. 561; Mansfield, C. & L. M. Ry. Co. *v.* Swan (1884), 111 U. S. 379.

[7] Home Ins. Co. *v.* Morse (1874), 20 Wall. 445; Insurance Co. *v.* Dunn (1873), 19 Wall. 214; Kanouse *v.* Martin (1853), 14 How. 23; 15 How. 198 (1853).

operating a railroad in a State by a foreign corporation shall be regarded as a waiver of the rights of the latter to remove suits against it is unconstitutional and ineffective as a statutory waiver.[1]

Nor can a State, by making special provisions for the trial of any particular controversy, as, for instance, the amount of compensation which shall be paid to the owner of land condemned by the exercise of the right of eminent domain, deprive a litigant of the right of removal.[2]

§ 434. **What is a Controversy.** — A controversy within the meaning of the act of Congress is involved in a suit whenever any property or claim of the parties capable of pecuniary estimation is the subject of litigation, and is presented by the pleadings for judicial determination.[3]

Hence, although the right of eminent domain is one that appertains to the sovereignty of the State in which the land to be condemned is situated, and the United States, a separate sovereignty, cannot interfere with the exercise of that right, yet when the sovereign power attaches conditions to its exercise, the inquiry whether the conditions have been observed is a proper matter for judicial cognizance; and if that inquiry takes the form of a proceeding before the courts between parties, the owners of the land on the one side and the company seeking the appropriation on the other, there is a "controversy" which is subject to the ordinary incidents of a civil suit, and the suit involving it is therefore removable to the federal courts if the requisite conditions of citizenship exist.[4]

§ 435. **Removal by Consent.** — The general rule is that an action pending in a State court cannot be removed to the United States Circuit Court by written stipulation, where there is nothing in such stipulation or in the record to show that by reason of the subject-matter or the character of the parties the latter court can take cognizance of it.[5]

But if the stipulation by which the parties agree to remove the cause binds them to do nothing more than they might by an injunction of the federal court have been compelled to do, the juris-

[1] Baltimore & Ohio R. Co. *v.* Cary (1876), 28 Ohio St. 208.

[2] Colorado Midland R. Co. *v.* Jones (1886), 29 Fed. Rep. 193.

[3] Gaines *v.* Fuentes (1875), 92 U. S. 10, 20.

[4] Boom Co. *v.* Patterson (1878), 98 U. S. 403, 408; Pacific R. R. Removal Cases (1885), 115 U. S. 1; Colorado Midland R. Co. *v.* Jones (1886), 29 Fed. Rep. 193.

[5] People's Bank *v.* Calhoun (1880), 102 U. S. 256.

diction of the latter will not be defeated,[1] and the parties can admit facts upon which the jurisdiction depends.[2]

A citizen of Ohio having brought in Ohio an action for damages for personal injuries against the receivers of a New York railroad corporation who were citizens of New York, which injuries were sustained on an Ohio railroad leased by the New York corporation, the Ohio and New York companies were made parties defendant. Such a case was held to have been properly removable on motion of the receivers to the federal court, on the ground that the sole controversy was between the plaintiff and the receivers.[3]

§ 436. **Who may remove a Cause.** — Who may remove a cause is a question which turns entirely upon the construction of the various statutes which have, from time to time, regulated removal proceedings. Under the act of 1789, only defendants could exercise the right when sued where they did not reside. The act of 1867 extended the right of removal to both plaintiff and defendant, and this enlargement of the right was continued by the act of 1875;[4] but by the act of 1888 the right was once more restricted to the defendant or defendants.

A federal court which has appointed a receiver of a railroad company in a foreclosure suit, will have jurisdiction of an action against its receiver for injuries caused by his employees, as ancillary to the main suit, without regard to the citizenship of the parties. And if such a suit be first brought in a State court, it can be removed to the federal court.[5]

§ 437. **Amount involved in Suit.** — The amount which must be involved in a suit to entitle a party to remove it was fixed at $500, exclusive of costs, until the enactment of the statute of 1887, which fixes the limit at $2,000, exclusive of interest and costs.

§ 438. **Removal when there are several Parties on either Side.** — The general rule which has been adhered to through all the

[1] People's Bank *v.* Calhoun (1880), 102 U. S. 256. Here the stipulation was made in a case in which a bank was attempting in a State court to enforce under an attachment a lien conflicting with that of the mortgage, which the trustees were foreclosing in the federal court.

[2] Railroad Company *v.* Ramsey (1874), 22 Wall. 322, 326. Here the record had been burnt after the removal of the case to the federal court, and the parties having asked that the record be renewed, it was partially renewed, but made no mention of facts necessary to give jurisdiction; it was held that the court might presume from the action of the parties, and of the court below, that jurisdiction appeared on the face of the record which had been destroyed.

[3] Chamberlain *v.* New York, Lake Erie, & Western R. Co. *et al.* (1895), 71 Fed. Rep. 636.

[4] Burnham *v.* Chicago, Dubuque, & Minnesota R. Co. (1876), 4 Dill. 503, where one of the defendants was a corporation chartered in the State where suit was brought.

[5] Carpenter *v.* Northern Pac. R. Co. *et al.*, 75 Fed. Rep. 850 (1896).

various legislation on the subject is that, when there are several plaintiffs or several defendants, all the parties on one side must be citizens of the State where suit is brought, and all on the other side must be citizens of the other State or States.[1]

But in the application of this rule, nominal, formal, and unnecessary parties are not taken into account.[2]

Thus, if individual defendants are joined with a corporation, merely as being agents and officers of the corporation, this joinder may be disregarded for the purpose of deciding whether removal is proper.[3]

So if the relative priority of the claims of a judgment creditor and of a trustee suing for bondholders is the sole controversy, the corporation being insolvent and its stock worthless, the corporation, if joined with the judgment creditor, will be regarded as a merely nominal party.[4]

So also, where non-resident plaintiffs expressly sue as a class for the benefit of a class, all of whom, whether named or not, may avail themselves of the decree if obtained, a citizen member of the class who is joined with them may be regarded as an unnecessary party, whose joinder does not affect the defendant's right of removal.[5]

On the other hand a necessary party who is wrongfully excluded from the proceedings in the State court will be treated in the federal court as an actual party, and the motion for removal determined accordingly.[6]

And as it is proper that, when joint parties seek to upset judicial decrees, charge trusts, and fasten supposed liens in consequence of joint interests, all of them should be before the court, in order that it may be known to what extent, and in whose favor, a decree may be had, jurisdiction of a suit to have certain bonds declared a lien upon the defendant's property cannot be entertained by a federal court, where it is shown that, although the plaintiff himself is a non-resident, he is only one of many joint owners who have assigned their bonds to him for the pur-

[1] See especially case of the Sewing Machine Companies (1873), 18 Wall. 553, where the court, Bradley and Miller, JJ., dissenting, held that the act of 1875 had not altered this rule. Compare Hervey *v.* Illinois Midland R. Co. (1876), 7 Biss. 103.

[2] Removal Cases (1879), 100 U. S. 457; Barney *v.* Latham (1880), 103 U. S. 205; Pond *v.* Sibley (1881), 19 Blatch. 189; Hervey *v.* Illinois Midland R. Co., 7 Biss. 103; McHenry *v.* New York, P. & O. R. Co. (1885), 25 Fed. Rep. 65; Chicago, St. Louis, & New Orleans R. Co. *v.* McComb (1879), 17 Blatch. 371.

[3] Pond *v.* Sibley (1881), 19 Blatch. 189.

[4] Hervey *v.* Illinois Midland R. Co. (1876), 7 Biss. 103.

[5] McHenry *v.* New York, P. & O. R. Co. (1885), 25 Fed. Rep. 65.

[6] Hack *v.* Chicago & G. S. R. Co. (1885), 23 Fed. Rep. 356.

pose of the litigation, and that those who hold a majority interest in the bonds are citizens of the State where the suit is brought.[1]

§ 439. **Arrangement of Parties according to their Real Interests.** — Prior to the Removal Act of 1875 the pleadings only were looked at, and the rights of the parties in respect to a removal were determined solely according to the position they occupied as plaintiffs or defendants in the suit. Since the enactment of that statute the position of the parties in the record is immaterial. For the purposes of a removal, the matter in dispute may be ascertained, and the parties arranged on opposite sides of that dispute. If in such arrangement it appears that those on one side are all citizens of different States from those on the other, the suit may be removed.[2]

Thus, where a mortgage trustee is made a party defendant to a suit by a bondholder against the railroad company, because such trustee asserts that no duty is imposed on him in respect to the matters involved in the suit, and has refused to bring suit, the court has jurisdiction, even though the complainant and the trustee are citizens of the same State, on the ground that no relief is asked against the trustee, and his interests and those of the plaintiff are identical.[3]

A similar doctrine has been applied where suit was brought against the company, and there were two boards of directors, one illegal and the other legal, and the latter refused to bring suit to redress the wrong complained of. Their interests being really identical with the interests of the complainants in the suit, the jurisdiction of the federal court was held not to be defeated by the fact that they were citizens of the same State as those complainants.[4]

Still less can the citizenship of a trustee who is not a party in fact, and has refused to be made a party or otherwise execute the trust, defeat the right of removal.[5]

§ 440. **Introduction of New Party ineffectual to divest Jurisdiction.** — After the jurisdiction of the federal court has once attached, it

[1] Sahlgaard *v.* Kennedy (1882), 13 Fed. Rep. 242.

[2] Removal Cases (1879), 100 U. S. 457, affirmed in Pac. R. Co. *v.* Ketchum (1879), 101 U. S. 289, 298; Turner *v.* Farmers' Loan & Trust Co. (1882), 106 U. S. 552, 555; Coal Co. *v.* Blatchford (1870), 11 Wall. 172, 174.

[3] Pacific R. Co. *v.* Ketchum (1879), 101 U. S. 289, followed in Barry *v.* Missouri, K. & T. R. Co. (1886), 27 Fed. Rep. 1.

[4] Pond *v.* Vermont Valley R. Co. (1874), 12 Blatch. 280.

[5] Hack *v.* Chicago & G. S. R. Co. (1885), 23 Fed. Rep. 356.

As to the jurisdiction of a federal court, growing out of the different citizenship of the parties, and the arrangement of parties, see Kildare Lumber Co. *v.* National Bank of Commerce *et al.*, 69 Fed. Rep. 2; s. c. 16 C. C. A. 107 (1895).

cannot be ousted by the fact that, without the consent or concurrence of the original plaintiff, a citizen of the same State as the defendants is, by leave of the court, made a party plaintiff.[1]

§ 441. **The Rule that, where the State is a Party to the Suit,** the federal courts have no jurisdiction, is not applicable where the State is merely a party in interest, but not a party to the record. The United States Circuit Court, therefore, has jurisdiction in such a case, where it has jurisdiction of the State's agent who has charge of the property as a trustee, and where the property which is the subject of the trust is stock and shares in a railroad company held by it in pledge for the security of a debt due to the complainant.[2]

§ 442. **Separable Controversies.** — By the Removal Act of 1875 it was provided that when in certain suits there should be a controversy which was wholly between citizens of different States, and could be fully determined between them, either one or more of the plaintiffs or defendants actually interested in such controversy might remove the suit to the Circuit Court of the United States, and the act of 1887 continues this privilege as respects the defendants. Under the earlier act the residence of one of the defendants in the State where suit is brought will not defeat the right, provided that the controversy between the remaining parties is one which can be wholly determined between them; as where mortgage trustees who are citizens in Massachusetts bring suit against the debtor company, an Iowa corporation, and join as defendants an Illinois and an Indiana corporation, who claim liens on the railroad property. Here there is a controversy as to the priority of liens lying wholly between citizens of different States, and the cause is removable.[3]

So also a party who intervenes in a suit, and asks to have the priorities determined between his own lien and the one which it is the object of the suit to enforce, has a right to remove the cause.[4]

[1] Graham *v.* Boston, Hartford, & Erie R. Co. (1883), 14 Fed. Rep. 753, 762. The court in this case held that jurisdiction once having attached, it could not be defeated by the fact that the parties whom the plaintiff represented were disqualified. He neither consented nor concurred in the making of this citizen a party. The admission of the latter by leave of the court did not, in a jurisdictional sense, make him a plaintiff. He acquired thereby no control of the suit. The original plaintiff was *dominus litis*, and the suit must stand or fall on the case which he makes. If the admission of this party was an error of the court, it should not prejudice the original plaintiff, as it was not done at his instance.

[2] Swasey *v.* North Carolina Railroad Co. (1874), 1 Hughes, 17.

[3] Burnham *v.* Chicago, Dubuque, & Minnesota R. Co. (1876), 4 Dill. 503.

[4] Snow *v.* Texas Trunk R. Co. (1882), 4 Woods, 394.

So also a suit to enforce a lien for professional services against the purchasers of a railroad at the foreclosure sale which terminated the suit in which the services were rendered, is not a graft upon or appendage to the original suit, and may, if the other requisite conditions exist, be removed to the federal court.[1]

So also there is a separable controversy which renders a cause removable when the questions involved are whether certain bonds which the complainant seeks to enforce by obtaining a foreclosure of the mortgage securing them are valid debts against the company, and whether the officers of the company have been guilty of the breaches of trust alleged against them.[2]

On the other hand, where a receiver has been appointed for a corporation in a State court, and empowered to make contracts, a contractor litigating with the receiver and other claimants in that court as to what he is entitled to have paid him on his contract cannot remove the case to the United States Circuit Court. Under such circumstances, whatever controversy there is has arisen in that court in the administration of the property or assets which it has taken in charge. It is not the case of an independent controversy which existed when the suit was commenced, but one which had arisen in the execution of the power of the court.[3]

Nor does a creditor's bill to subject incumbered property to the payment of his judgment, by sale and distribution of the proceeds among lienholders according to priority, create a separate controversy as to the separate lienholders, parties respondent, within the meaning of the Removal Act, although their respective defences may be separate.[4]

§ 443. **What does not affect the Right to remove.** — Collateral issues connected with the property in the State court do not destroy the right of removal, providing the parties desiring to remove are within the statute.[5]

Even if decrees had been made and appeals taken therefrom.[6]

Nor in a suit by a bondholder to foreclose the mortgage will

[1] Pettus *v.* Georgia Railroad & Bkg. Co. (1879), 3 Woods, 620.

[2] Osgood *v.* Chicago, Danville, & Vincennes R. Co. (1875), 6 Biss. 330.

[3] Buell *v.* Cincinnati, Effingham, & Quincy Construction Co. (1881), 9 Fed. Rep. 351.

[4] Fidelity Ins. Co. *v.* Huntington (1886), 117 U. S. 280.

[5] Osgood *v.* Chicago, Danville, & Vincennes R. Co. (1875), 6 Biss. 330.

[6] Farmers' Loan & Trust Co. *v.* Chicago, Pekin, & South Western R. Co. (1879), 9 Biss. 133. But it seems that the decision of the higher court of the State upon such questions will be carried out by the federal court in the same manner as they would have been by the State court if the cause had remained there.

the fact that there are various judgment creditors whose rights are subject to the prior liens of the bondholders affect the power to remove, as their rights remain unchanged.

Nor will that right be affected by the fact that a judgment creditor has filed a cross-bill, for then it would always be in the power of a creditor to prevent the operation of the statute.[1]

The fact that the sheriff, under an order of the State court, is in possession of the property which is the subject-matter of the suit does not defeat the right of removal.[2]

Nor will possession by the trustees under the order of a State court, made in a suit by the stockholders of a railroad company, against the company and its directors, charging the latter with certain wrongful acts to the injury of such stockholders, affect the right to remove a suit brought by bondholders under a deed of trust which is paramount to the rights of the stockholders. In such a case the possession will follow into the federal court.[3]

Since any action by a State court in a cause which has been properly removed is a usurpation, the fact that the party at whose instance it was removed has, after the removal, contested the suit in the State court does not, after judgment against him, constitute a waiver on his part of the question of the jurisdiction of the State court to try the case.[4]

The fact that property is acquired for the purpose of enabling a party to sue in the federal courts will not defeat his right to sue therein, provided the right is otherwise perfect.[5]

The motive of the transfer under such circumstances will not be inquired into.[6]

The only ground of objection that is valid being that the assignor or grantor is the real party in interest, and the plaintiff on the record nominal and colorable, his name being used merely for the purpose of jurisdiction.[7]

[1] Osgood *v.* Chicago, Danville, & Vincennes R. Co. (1875), 6 Biss. 330.

[2] Kern *v.* Huidekoper (1880), 103 U. S. 485. The court distinguished the circumstances from those in such cases as Freeman *v.* Howe (1860), 24 How. 450, which decide that property held by an officer of the court, by virtue of process issued in a cause pending therein, cannot be taken from his possession by the officer of another court of concurrent jurisdiction, upon process issued in *another* case pending in the latter court. To the same effect see Osgood *v.* Chicago, Danville, & Vincennes R. Co. (1875), 6 Biss. 330.

[3] Scott *v.* Clinton & Springfield R. Co. (1876), 6 Biss. 529.

[4] Insurance Co. *v.* Dunn (1875), 19 Wall. 214; Removal Cases (1879), 100 U. S. 457; Railroad Co. *v.* Mississippi (1880), 102 U. S. 135; Kern *v.* Huidekoper (1880), 103 U. S. 485.

[5] Blackburn *v.* Selma, M. & M. R. Co. (1879), 2 Flip. 525.

[6] McDonald *v.* Smalley (1828), 1 Peters, 620.

[7] Smith *v.* Kernochen (1849), 7 How. 198.

§ 444. **The whole Cause is removed.** — The removal of the controversy from the State to the Federal court takes the whole suit, though there may be other controversies in it, and the subject-matter of the suit is in possession of the State court.[1]

The rule is not altered by the fact that the removal of the separable controversy which takes the whole cause will have the effect of bringing into the federal court another controversy which is between citizens of the same State. In this respect the jurisdiction of that court is larger than can be obtained by an action brought there in the first instance.[2]

After a proper petition and bond have been filed in the State court, the filing of the transcript of the record in the United States Circuit Court invests that court with full jurisdiction of the cause, irrespective of the action of the State court.[3] The general principle being that, if the cause is removable, and the statute providing for its removal has been complied with, no order of the State court is necessary to confer jurisdiction on the court of the United States, and no refusal of such an order can prevent this jurisdiction from attaching.[4]

Since the State court has no jurisdiction in granting or denying the removal after the petition and bond are duly filed, it is immaterial that the filing was made in vacation.[5]

Every step which a State court takes in the exercise of jurisdiction in a case, after an application has been made in proper form for its removal, and facts submitted which are such as to bring it within the provision of the act of Congress, is *coram non judice* and absolutely void.[6]

The jurisdiction of a court of the United States to which a cause has been removed from a State court relates back to the time of the original service of process.[7]

[1] Farmers' Loan & Trust Co. *v.* Chicago, Pekin, & South Western R. Co. (1879), 9 Biss. 133; Hervey *v.* Illinois Midland R. Co. (1876), 7 Biss. 103; Kern *v.* Huidekoper (1880), 103 U. S. 485; Osgood *v.* Chicago, Danville, & Vincennes R. Co. (1875), 6 Biss. 330.

It seems, as stated above, that the decisions of the higher court of the State upon such incidental questions will be only carried out by the federal court in the same manner as would have been done by the State court if the cause had remained there. Farmers' Loan & Trust Co. *v.* Chicago, Pekin, & South Western R. Co. (1879), 9 Biss. 133.

[2] Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1885), 23 Fed. Rep. 513.

[3] Kern *v.* Huidekoper (1880), 103 U. S. 485.

[4] Insurance Co. *v.* Dunn (1875), 19 Wall. 214, followed in Kern *v.* Huidekoper (1880), 103 U. S. 485.

[5] Osgood *v.* Chicago, Danville, & Vincennes R. Co. (1875), 6 Biss. 330, followed in Owens *v.* Ohio Central R. Co. (1884), 20 Fed. Rep. 10, 15.

[6] Gordon *v.* Longest (1842), 16 Pet. 97; Kern *v.* Huidekoper (1880), 103 U. S. 485. See also Yulee *v.* Vose (1879), 99 U. S. 539, 546.

[7] Owens *v.* Ohio Central R. Co. (1884), 20 Fed. Rep. 10.

And it seems that where the State law allows service in chancery proceedings by publication, and a cause is removed after publication, but before proof thereof has been filed in the State court, the State court will thus have acquired jurisdiction by such publication, and that the federal court will retain it.[1]

§ 445. **What bars the Right of Removal.** — To bar the right of removal, it must appear that, when the application was made, the trial of the State court was actually in progress in the orderly course of proceedings.[2]

Ex parte orders made without notice to the defendant are not a "final trial or hearing" which cuts off the right of removal. Hence the entry, before the application for removal, of an office order, that the bill will be taken *pro confesso* as against two of several defendants, for want of a formal appearance by paper filed, such order under the rules not being absolute, will not prevent a removal.[3]

§ 446. **When the Petition and Bond must be filed.** — Under the provision that the petition for removal of the cause shall be filed in the suit in the State court before the term at which said cause could be first tried, the petition is filed in time if, when it is filed, there has been no issue made up in the case on which the case could be tried, although a term has elapsed during which that might have been done.[4]

The rule as to the petition's being in time if presented before issue joined is applicable to a case in which the removal is petitioned for by parties intervening in the original suit.[5]

§ 447. **Contents of Application.** — In a suit by a corporation of one State against a citizen of another State it is not necessary in a petition for removal by the defendant to state that he is a citizen of such other State, and it is not necessary to state that he was such citizen when the suit was commenced.[6]

But if the application is grounded on the federal law which permits a defendant to remove a cause on a petition that he has a defence arising under the constitution, or a treaty or law of the United States, it must not be concluded in merely general terms, but must specifically set forth what the defence is. If the nature of the defence is neither shown by the petition nor appears from

[1] Turner *v.* Indianapolis, B. & W. R. Co. (1878), 8 Biss. 380; s. c. 24 Fed. Cas. 367, Case No. 14,259.

[2] Removal Cases (1879), 100 U. S. 457.

[3] McHenry *v.* New York, P. & O. R. Co. (1885), 25 Fed. Rep. 65.

[4] Scott *v.* Clinton & Springfield R. Co. (1876), 6 Biss. 529; s. c. 21 Fed. Cas. 820, Case No. 12,527. See also Yulee *v.* Vose (1879), 99 U. S. 539, 545.

[5] Snow *v.* Texas Trunk R. Co. (1882), 4 Woods, 394.

[6] Chicago, St. Louis, & New Orleans R. Co. *v.* McComb (1879), 17 Blatch. 371.

the record, the defendant is not entitled to a removal. Whether the necessary conditions entitling him to a removal is a question which may be examined into by a State court.[1]

§ 448. **Formal Requisites of Record and Petition.** — It is not essential that the record be certified by the judge of the State court: the attestation of the clerk under the seal of the court is sufficient. Nor is it necessary that the petition for removal be verified by affidavit.[2]

§ 449. **Bringing up the Record.** — Where the record of the State court is before the United States Circuit Court, the issue of a writ of *certiorari* by the latter court would be a useless act.[3]

§ 450. **Irregularities in the Removal of a Cause.** — These do not vitiate it, nor authorize the federal court to remand or dismiss it; if it has jurisdiction, the cause should be retained.[4]

§ 451. **Waiver of Objections to Removal.** — Waiver of objections to removal founded on the citizenship of the parties or on irregularities in the bond will be implied, if such objections are not raised in eighteen months.[5]

§ 452. **Requisites of Removal Bond.** — Nothing is to be secured by the bond in removal cases but the filing of the transcript in the United States Circuit Court on the first day of its (then) next term, and the payment of any costs that may be awarded by that court in case it shall hold that the suit had been wrongfully or improperly removed. "Good and sufficient security" is all that is required, and this is satisfied if there is one surety able to respond to the condition of the bond. The State court has no discretion in such a matter. Its action is governed by fixed principles. Hence, if no objection is made to the pecuniary responsibility of the one person who signed as surety, and was competent under the laws of the State to do so, it is an error for the court to refuse to accept the bond because a second surety was an attorney of the court, who was prohibited by the laws of that State from becoming such a surety.[6]

[1] Texas & Pacific Ry. Co. *v.* McAllister (1883), 59 Tex. 349; 12 Am. & Eng. R. R. Cas. 289, where the doctrine of the text was applied in the case of a petition for removal presented by a corporation chartered by Congress.

[2] Osgood *v.* Chicago, Danville, & Vincennes R. Co. (1875), 6 Biss. 330.

[3] Scott *v.* Clinton & Springfield R. Co. (1876), 6 Biss. 529; s. c. 21 Fed. Cas. 820, Case No. 12,527.

[4] Osgood *v.* Chicago, Danville, & Vincennes R. Co. (1875), 6 Biss. 330.

[5] Hervey *v.* Illinois Midland R. Co. (1880), 3 Fed. Rep. 707.

[6] Removal Cases (1879), 100 U. S. 457. For a discussion as to the effect of the act of 1875 upon the requisites of a bond, where the application to remove is based on the "local prejudice" sections of the act of 1867, see Farmers' Loan & Trust Co. *v.* Chicago, Pekin, & South Western R. Co. (1879), 9 Biss. 133; s. c. 8 Fed. Cas. 1043, Case No. 4665.

Thus when a foreign railroad corporation purchases the rights, titles, properties, and franchises of a domestic railroad corporation, which latter corporation is, by the terms of its charter, authorized to sell such rights, titles, properties, and franchises, and the purchasing company assumes all the liabilities of the purchased road, and becomes merged and consolidated with it, doing business under its charter, such purchasing company becomes a domestic corporation.

A like result will follow from a purchase under an act authorizing the sale of two domestic corporations to a foreign corporation, and providing that such sale shall pass the title to the corporate franchises and property, and that the purchasing company shall thereby "become possessed of the rights of charter and property sold," and thereafter have, hold, and use the same in its "own name and right."

CHAPTER XXIII.

PLEADINGS.

§ 453. **Introductory.** — This chapter contains a summary of various rulings on points of equity pleading which have been decided in cases falling within the scope of this treatise.[1]

§ 454. **The Bill in Foreclosure Suits.** — The ownership of the bonds which are the subject of a foreclosure suit is sufficiently alleged, where the complaint avers that the coupons maturing at a certain time are "due and wholly unpaid, together with interest thereon, to your orator and other holders of the bonds."[2]

In a complaint to foreclose as an equitable mortgage an instrument executed by a corporation, an allegation, in substance, that certain parties made defendants claimed some interest in a lien upon the mortgaged premises, but that such interest or lien, if any, was junior and subsequent to the lien of plaintiff's mortgage, is sufficient.[3]

A bill for foreclosure is defective as an original bill when it does not give a sufficient description of the mortgaged premises, nor show the terms and conditions of the mortgage, nor the amount secured by it, nor the sum due and unpaid by the mortgagor.[4]

[1] Daniell's Chancery Pleading and Practice, except so far as it illustrates doctrines based upon recent orders of the English Court of Chancery, may be considered as an authoritative commentary by which the equity rules promulgated by the Supreme Court in 1842 are to be interpreted. See the note of Mr. Justice Bradley in Thomson *v.* Wooster (1885), 114 U. S. 104, 112.

[2] Toler *v.* East Tennessee, Va. & Ga. Ry. Co. (1894), 67 Fed. Rep. 168.

[3] Howard *v.* Iron & Land Company of Minnesota *et al.* (1895), 62 Minn. 298; s. c. 64 N. W. Rep. 896.

[4] Mercantile Trust Co. *v.* Kanawha & O. R. Co. (1889), 39 Fed. Rep. 337. In this case the bill in question was filed in a circuit different from that in which the original suit was filed, the relief asked for being the appointment of a receiver. Mr. Justice Harlan ruled that such an appointment could be made only in a separate,

But a bill to foreclose a deed of trust executed to secure bonds issued and put in circulation by a corporation and made payable to bearer is not demurrable because it fails to allege to whom such bonds were negotiable in the first instance, or how much was paid for them, or when they were issued. Nor is a bill averring defaults in payment of interest demurrable because it fails to allege that the interest coupons were presented for payment at the office or agency at which they were payable.[1]

The only question in an action for foreclosure of an equitable mortgage given by a corporation which lienholders, who are defendants, can raise on a demurrer that the complaint does not state a cause of action, is whether the complaint showed a valid mortgage as between the parties.[2]

Lienholders, defendants to an action to foreclose an equitable

independent suit, and for the purpose of commencing this the bill before him was held to be insufficient. This ruling was substantially an indorsement of the doctrine applied by Judge Gresham in the Wabash case. Mr. Justice Harlan, in rendering his judgment, said: "The request that this court will simply confirm the appointment of a receiver, made in another circuit, and by its order invest that receiver with the possession and control of the mortgaged premises within this district, — no other relief being contemplated, — is, in effect, a request that this court will compel all who have claims and rights in respect to the mortgaged property situated in West Virginia to seek relief in the original suit for foreclosure pending in another State; and this, notwithstanding such parties may have the right, under existing legislation, to invoke the jurisdiction of this court, or of some court of general jurisdiction established by this State. It might be well if Congress would so enlarge or regulate the jurisdiction of the courts of the United States as to enable a Circuit Court in which is brought an original suit for the foreclosure of a mortgage resting upon an interstate railroad to take actual possession, by its officers, of the entire line, and of all the mortgaged property, wherever situated, and administer it for the benefit of all concerned; preserving in that mode the unity of the railroad, and the just rights of mortgagors, mortgagees, creditors, as well as those of the general public interested in commerce among the States. But there has been no such legislation, and we do not see our way clear to effect any such result by judicial orders merely. A good deal was said at the argument about the injury that might possibly ensue to mortgagors, mortgagees, creditors, and the public, if an interstate railroad, covered by one mortgage, be placed under the management of different receivers, each acting under the orders of the court appointing him, and sold under separate decrees, rendered in distinct foreclosure suits brought in different Circuit Courts of the United States. Undoubtedly railroad property of that kind could be very materially injured in value, and the general public put to serious inconvenience, if the courts in which such separate suits are brought decline to act in harmony, or according to some fixed plan, in the administration and sale of the property. It is not, however, to be assumed that this court, if its jurisdiction is properly invoked in reference to this railroad, so far as it lies in West Virginia, will fail in any duty imposed upon it by law, or the comity prevailing between courts of equal dignity and authority." Mercantile T. Co. *v.* Kanawha & O. Ry. Co., 39 Fed. Rep. 337.

[1] Savannah & Memphis R. Co. *v.* Lancaster (1878), 62 Ala. 555.

[2] Howard *v.* Iron & Land Company of Minnesota *et al.* (1895), 62 Minn. 298; s. c. 64 N. W. Rep. 896.

mortgage, cannot, by demurrer, raise the question that plaintiff's mortgage was, on its face, void as to creditors and subsequent incumbrancers.[1]

§ 455. **The Bill in Suits by Trustees to obtain Possession.** — A bill filed by trustees to obtain possession after default with a view to foreclosure usually asks that, unless the sums due to the bondholders be paid within a time to be prescribed, possession of the mortgaged premises be given by the corporation to the plaintiffs for the purposes of foreclosure.[2]

§ 456. **Supplemental Bills.**[3] — After the filing of an original bill for foreclosure of mortgage for a default in interest, if other defaults of interest occur and it be desired to change the action with a view to declaring the principal debt due, such facts are germane to the foreclosure proceedings, and a supplemental bill is the proper mode to bring them before the court.[4]

A supplemental bill will be dismissed, as relating to matters not in their nature supplemental, where it is filled with matters of complaint which have occurred since the original decree, and which have no necessary connection with that decree, such as a claim for the use of rolling-stock, the title to which is still in litigation, and an alleged violation of the charter, and attempt to divert the travel and interrupt the through communication in running the road.[5]

After the trustees have taken a decree *pro confesso*, bondholders may, by filing a petition which alleges that the original bill was not sufficiently specific in its description of the mortgaged property to secure their claims to a lien on certain after-acquired personalty, obtain an order directing the trustees to file a suplemental bill distinctly and fully setting up the claim of the petitioners, and making all parties in adverse interest defendants. The litigation under such supplemental bill to be confined to subject-matter thereof.[6]

A supplemental bill being a mere adjunct to an original bill, it is not necessary to serve a subpœna upon any of the parties named therein except those who were not included in the original bill.[7]

[1] Howard *v.* Iron & Land Company of Minnesota *et al.* (1895), 62 Minn. 298; s. c. 64 N. W. Rep. 896.

[2] See, for instance, Shaw *v.* Norfolk County R. Co. (1855), 5 Gray (Mass.), 162.

[3] See generally Daniell Ch. Pl., §§ 1515 *et seq.*; Story's Eq. Pl., 332 *et seq.*

[4] New York Security & Trust Co. *v.* Lincoln St. Ry. Co. *et al.* (1896), 74 Fed. Rep. 67, 70.

[5] Minnesota Co. *v.* St. Paul Co. (1867), 6 Wall. 742.

[6] Williamson *v.* New Jersey Southern R. Co. (1874), 25 N. J. Eq. 13.

[7] Shaw *v.* Bill (1877), 95 U. S. 10, 14. In this case the defendant company was ruled to answer, and the new parties appeared by counsel. This was held sufficient.

§ 457. **The Answer.**[1] — The answer of stockholders who appear by leave of the court cannot be taken as the answer of the corporation itself; for the latter must not be under oath, but under the common seal of the corporation. An omission on the part of the corporation to appear and answer in conformity with this rule entitles the plaintiffs to an order that the bill be taken *pro confesso*.[2]

Lienholders made parties defendant in an action to foreclose an equitable mortgage executed by a corporation, the complaint in which action has sufficiently alleged that they claimed such liens, if they have any interest, must set it up by answer.[3]

§ 458. **Cross-bills.**[4] — It frequently happens that a complete decree cannot be made without a cross-bill, to bring the whole matter in dispute completely before the court. In such a case it becomes necessary for some or one of the defendants to the original bill to file a bill against the plaintiff, and, if necessary, other defendants to the bill, or some of them, and bring the litigated point before the court.[5]

Thus, where a bill has been filed against certain parties and trustees in the mortgage, asking relief on the theory that they have participated in a fraudulent scheme by which the complainants were induced to invest in certain bonds, any of the defendants who wish to set up their discharge in bankruptcy as a defence may file a cross-bill for that purpose.[6]

So a bill in which a trustee, who has been brought in by supplemental bill as a defendant, in a suit commenced by an unsecured creditor who asks for a receiver and a sale of the property, — such supplemental bill alleging that the plaintiff's claim is an equitable lien on the property superior to that of the mortgage, — sets up the mortgage and a default in the payment of the bonded interest, and asks for a receivership and a sale, and a decree to the effect that the plaintiff's claim, if a lien at all, is inferior to that of the mortgage, is properly styled and treated as a cross-bill. Such a bill comes under the head of cross-bills filed to obtain full relief to all parties, touching the matters of the original bill. The mere fact that, so far as it seeks the further aid of the court beyond the purposes of defence to the original bill, it is not a pure cross-bill is

[1] See generally Daniell's Ch. Pl., ch. xvii.; Story's Eq. Pl., ch. xviii.

[2] Bronson *v.* La Crosse & Milwaukee R. Co. (1863), 2 Wall. 283, 302.

[3] Howard *v.* Iron & Land Company of Minnesota *et al.*, 62 Minn. 298; s. c. 64 N. W. Rep. 896.

[4] See Daniell's Ch. Pl., ch. xxxiv.; Story's Eq. Pl., §§ 389 *et seq.*

[5] Daniell's Ch. Pl., § 1548; Story's Eq. Pl., § 392.

[6] Banque Franco-Egyptienne *v.* Brown (1885), 24 Fed. Rep. 106.

immaterial. Different relief from that sought in the original bill will necessarily be asked for by a pleading filed on the theory that without it a complete determination of the matters already in litigation cannot be obtained.[1]

If the cross-bill sets up new matter which is intimately connected with the subject-matter of the original bill, it is error to strike it from the files and refuse leave to defendant to refile and prosecute it. In such a case it is impossible to say that all the facts have been as fully shown as they would have been if the defendant had been allowed to investigate them under the allegations of his cross-bill.[2]

When a cross-bill is necessary to bring the parties before the court, in order that equity may be done, the court may order one filed; but where a party is merely entitled to a cross-bill in order to obtain affirmative relief, he may or may not file it, at his discretion, and without prejudice to his rights.[3]

The circumstances under which the filing of a cross-bill is optional are frequently illustrated in those cases where the interests of co-defendants are antagonistic. Thus where the original bill was filed by a judgment creditor denying the validity of the bonds, a cross-bill may properly be filed between the several bondholders who assert antagonistic interests under the deed of trust, for the purpose of adjusting and settling their conflicting liens and priorities.[4]

If such co-defendants wish to have the equities between them settled without instituting an original suit for that purpose, the proper course is to make application to the court at an early stage of the litigation. To undertake to do this by filing a cross-bill after the rendition of the decree is a course which has been strongly condemned by the Supreme Court of the United States.[5]

As a general rule a cross-bill can be filed only by one who is an actual party to the suit. But creditors belonging to the classes whose claims are preferred to the mortgage lien, either by virtue of some statute passed for the protection of material-men and laborers, or under the doctrine of Fosdick *v.* Schall,[6] as to the equitable liens acquired by those who, by labor or supplies furnished to the company, keep up the company as a going concern,

[1] Morgan's La. & Texas Railroad & St. Ship Co. *v.* Texas Central R. Co. (1890), 137 U. S. 171; 45 Am. & Eng. R. R. Cas. 631, citing Story's Eq. Pl., § 389.

[2] Peoria & Springfield R. Co. *v.* Bryan (1879), 5 Bradw. (Ill.) 387, citing Jones *v.* Smith (1852), 14 Ill. 229.

[3] American Loan & Trust Co. *v.* East & West R. Co. (1889), 37 Fed. Rep. 242.

[4] Morton *v.* New Orleans & Selma R. Co. (1885), 79 Ala. 590.

[5] Bronson *v.* Railroad Company (1862), 2 Black, 524, 528.

[6] 99 U. S. 235 (1878).

may, although not parties to the original suit, file a cross-bill in behalf of themselves and others holding like claims, for the purpose of having those claims declared a paramount charge on the earnings of the road in the hands of the receiver.[1]

Such a cross-bill is not multifarious, since the orators are seeking, as a class, to enforce a common right against a common fund, which they assert to be in equity, chargeable in their favor.[2]

A bondholder is deemed a *quasi* party to a suit in which he is represented by the trustee of the mortgage, and, as the question of the trustee's fraud is one incidental to the suit, a bondholder, if he wishes to raise that question, may and should file a cross-bill for that purpose, and not institute an independent suit. If he takes the latter course, his bill will be dismissed, and the trustee's suit alone proceeded with, the bondholder having the option of filing a cross-bill therein, and thus obtaining full relief.[3]

One who is already a party to the suit need not file a cross-bill for the purpose of obtaining the appointment of a receiver.[4]

The filing of a cross-bill on a petition without the leave of the court is an irregularity, and such a cross-bill may be properly set aside.[5]

But the permission of the court to file a cross-bill will, upon appeal, be presumed to have been given when action has been taken upon it.[6]

§ 459. **Dismissal of Bill by Complainant, and its Effect.** — The general rule is that a complainant may, upon payment of costs, dismiss his own bill at any time before the rendition of a final or

[1] Poland *v.* Lamoille Valley R. Co. (1879), 52 Vt. 144; s. c. 4 Am. & Eng. R. R. Cas. 408.

[2] Poland *v.* Lamoille Valley R. Co. (1879), 52 Vt. 144; s. c. 4 Am. & Eng. R. R. Cas. 408.

[3] Stern *v.* Wisconsin Central R. Co. (1880), 1 Fed. Rep. 555.

[4] Indiana Southern R. Co. *v.* Liverpool, London, & Globe Ins. Co. (1883), 109 U. S. 168.

[5] Bronson *v.* La Crosse & Milwaukee R. Co. (1863), 2 Wall. 283. There a stockholder petitioned for leave to answer in the name of the mortgagor corporation, and to file a cross-bill. Leave was granted to put in the answer, but not to file the bill, which was for this reason set aside. This case has been declared not to be an authority for any wider proposition than that a person who is a *stranger to the suit* cannot file a cross-bill without leave. Neal *v.* Foster (1888), 13 Sawyer, 236; s. c. 34 Fed. Rep. 496, per Deady, J. It seems, however, very doubtful whether the position thus taken by the learned circuit judge can be sustained in view of the language of the Supreme Court of the United States in the above case, which is apparently the only direct decision on the subject. The decision cited in the following note certainly implies the existence of a wider rule than that supposed by Judge Deady to be laid down in the Bronson case, as the companies whose cross-bills were asserted to have been filed without leave were parties defendant in the original suit.

[6] Muller *v.* Dows (1877), 94 U. S. 444.

interlocutory decree. After a decree has been made determining the rights of a party defendant, or such proceedings have been taken as entitle the defendant to a decree, the complainant will not be allowed to dismiss his bill without the consent of the defendant.[1]

The fact that the defendant has not only answered, but has also filed a cross-bill for the purpose of securing more complete relief, merely affords stronger grounds for the application of the rule. Hence, where several defendants have independent rights in the subject-matter of the suit, and one defendant after having answered, setting up his particular right, files a cross-bill to enforce it, and the cases proceed together and are heard together, and an interlocutory decree is entered to protect and enforce the rights thus set up, entitled as of both suits, the complainant in the original suit cannot, unless upon consent, dismiss his bill, and thus deprive the defendants of the right acquired by the decree.[2]

The exception to the general right of the plaintiff to dismiss his bill on payment of costs is not confined to rights acquired by some order or decree entered in the case. It may arise out of any proceeding in it, and may be found in the nature of the defence, the condition of the pleadings, the agreement of the parties, or any circumstance appearing in the record which shows that it would be inequitable to allow the dismissal. Thus where the defendant pleaded an estoppel which, if established, would amount to a defeasance of a lien claimed by the plaintiff on his property, and which it was the object of the bill to enforce, and it appeared that this defence could be endangered by a transfer of the lien after dismissal, the plaintiffs were not allowed to dismiss.[3]

But the mere ordinary inconveniences of double litigation are not such an injury to the defendant as will prevent the plaintiff from dismissing his bill. Such inconveniences are, in the view of the law, compensated by the costs.[4]

A dismissal is usually "without prejudice to the bringing of another suit;"[5] but the plaintiff will not be allowed to dismiss on these terms, unless the circumstances are such that the court would, upon final hearing, permit the bill to be so dismissed.[6]

[1] Chicago & Alton R. Co. v. Union Rolling Mill Co. (1883), 109 U. S. 702, citing Daniell's Ch. Pr., § 793, and numerous cases.

[2] Chicago & Alton R. Co. v. Union Rolling Mill Co. (1883), 109 U. S. 702.

[3] Stevens v. Railroad Companies (1880), 4 Fed. Rep. 97.

[4] Ibid.

[5] Daniell's Ch. Pr., § 790, note.

[6] Stevens v. Railroad Companies (1880), 4 Fed. Rep. 97.

When an original bill is dismissed before final hearing, a cross-bill filed by a defendant falls with it.[1]

So also, after a bill has been dismissed on the ground that it is defective as an original bill, an order made in the same suit, allowing a person to become a party defendant, will be set aside, and his answer and cross-bill will be stricken from the files, but without prejudice to any right that he may have to become a party to a subsequent suit brought by an amended bill.[2]

[1] Chicago & Alton R. Co. *v.* Union Rolling Mill Co. (1883), 109 U. S. 702.

[2] Mercantile Trust Co. *v.* Kanawha & O. R. Co. (1889), 39 Fed. Rep. 337.

CHAPTER XXIV.

PARTIES IN SUITS RELATING TO CORPORATE SECURITIES.

§ 460. **Introductory.** — The cases involving controversies as to the proper parties in suits relating to corporate securities may be divided into two classes: the first illustrating the application of the general rule of equity practice, that all persons materially interested in the subject of the litigation ought, under ordinary circumstances, to be made parties thereto, either as plaintiffs or defendants;[1] the second embracing instances of the well-established qualification of this rule, that a plaintiff may sue on behalf of himself and of all the others of a numerous class of which he is one, and that one of a numerous class may be brought into court as the only defendant, and be treated for the purpose of the suit as representative of the others in that class, on the allegation that they are too numerous to be made parties.[2] The doctrines applied in the first of these classes are in no way peculiar to suits for the enforcement of corporate mortgages, and it would therefore carry us beyond the scope of the present treatise to refer to any decisions except those actually rendered with regard to suits on railroad mortgages. The second class, dealing mainly with the peculiar functions of the trustee, has developed the familiar doctrine as to suits by or against a representative of a class in such a manner as to have created almost a separate branch of equity practice, and therefore calls for a fuller treatment.

Article I. — Rule requiring all Persons materially interested in the Mortgages to be joined either as Plaintiffs or Defendants.

§ 461. **Who should be Parties Plaintiff generally.** — As any one who has a real interest in the mortgage or the debt secured thereby may set the machinery of the law in motion to enforce the security, the most natural arrangement of the parties would be that all those whose interests are similar should join as plaintiffs in a suit for that purpose. But this is not necessary to enable the court to adjudicate their rights. Provided all the persons whom it is intended to bind by the decree are actually brought in as parties, it is immaterial whether they are brought in as plaintiffs or defendants. The familiar rule of equity procedure now embodied in the codes of many States is that any one whose interests are similar to those of the originator of the suit may, if he declines to be a plaintiff, be joined as a defendant.

The only proper parties to a foreclosure suit are the mortgagor,

[1] Daniell Ch. Pr., p. 190.

[2] Daniell Ch. Pr., p. 191.

the mortgagee, and those who have acquired any interest from either of them subsequently to the mortgage.[1]

Persons belonging to a class represented in a foreclosure suit, or on whose behalf the suit is brought, are regarded as *quasi* parties. They may have a standing in court, and be heard for the purpose of protecting their interest.[2]

§ 462. **Bondholders as Parties Plaintiff.** — Unless the mortgage qualifies in some way the inherent right of a secured creditor to institute proceedings for the enforcement of his security, it is plain that the bondholders may bring suit to foreclose whenever the neccssary breach of condition occurs. So far as the abstract existence of this right is concerned, it is immaterial whether the mortgage is executed directly to the bondholders or in the form of a trust deed.[3] The interposition of a trustee, however, although not limiting in any decree the abstract right itself, modifies the remedial procedure for its enforcement to the extent that the bondholders are not allowed to take any active steps in initiating a foreclosure suit, unless they show that the trustee has refused to bring the suit, or is for some reason an improper person to represent their interests. (See Art. II., below.)

Re Uruguay Central Ry. Co. (1879), 11 Ch. D. 372, was a proceeding in which a bondholder of a limited railway company presented a winding-up petition, the interest on the bond debt having fallen into arrear. The petition was dismissed on the ground, first, that the bondholder was not a creditor of the company, either at law or in equity, within the meaning of the Companies Acts, his right of action being through the trustees named in the trust deed under the provisions of which the bonds were issued; and, second, that assuming a bondholder to be a creditor, then, under the act mentioned, regard must be had to the wishes of the bondholders other than the petitioner, all of whom opposed the motion. It is, however, recognized, in this case, as a general rule that an unpaid creditor of a company is entitled to a winding-up order *ex debito justitiæ.*

[1] California Safe Deposit & Trust Co. *v.* Cheney Electric Light, Telephone, & Power Co. *et al.* (1895), 12 Wash. 138; s. c. 40 Pac. Rep. 732.

[2] Fidelity Trust & Safety Vault Co. *v.* Mobile St. Ry. Co., 53 Fed. Rep. 850 (1893); Searles *v.* Jacksonville, Pensacola, & Mobile R. Co. (1873), 2 Woods, 625; 21 Fed. Cases, No. 12,586.

[3] Chicago, Danville, & Vincennes R. Co. *v.* Fosdick (1882), 106 U. S. 47, 68; Mason *v.* York & Cumberland R. Co. (1861), 52 Me. 82; Mercantile T. Co. *v.* Lamoille Valley R. Co. (1879), 16 Blatch. 324; Webb *v.* Vermont Central R. Co. (1882), 20 Blatch. 218; Farmers' Loan & Trust Co. *v.* Winona & S. W. R. Co. (1893), 59 Fed. Rep. 957; Alexander *v.* Central Railroad of Iowa, 3 Dill. 487; s. c. 1 Fed. Cas. 363, Case No. 166; Woods Ry. Law, 1970, 1974. See Chap. XVIII., *ante.*

But a bondholder of a railway company is entitled to maintain an action on behalf of himself and the other bondholders for the specific performance of an agreement contained in the mortgage securing payment of his bonds, upon the refusal of the trustee of the mortgage to bring the action, and whatever rights are vested in the trustee through the mortgage instrument inure to the benefit of the bondholders.[1]

A trustee refusing to sue for specific performance of a covenant to bondholders to give an additional security under the mortgage, the bondholder, for himself and others, may bring such action before default upon the bonds.[2]

The bondholders cannot ignore the trustee of the mortgage securing them, and proceed in their own names to foreclose, without showing that they have requested the trustee to proceed and he has refused.[3]

If the company has failed to execute a trust deed to secure its bonds, the bondholders are, of course, the only possible parties plaintiff in any suit which touches their interest in the company's property.[4]

Though there may be differences in the immaterial circumstances of other bondholders from those of the complainant bondholder in an action against their trustee under a mortgage, it is proper that they be joined as parties plaintiff in his action.[5]

In a foreclosure suit brought by a trustee under different mortgages of diverse interests, a committee of each series of bonds will be made parties, so that they may represent the interests of each set of bondholders, unhampered by any obligation to opposing interests.[6]

While a trustee in foreclosure proceedings represents all the bondholders, and his acts are binding upon them,[7] and though when differences exist between the bondholders it is not improper that he should be governed by the voice of the majority acting in

[1] O'Beirne *v.* Allegheny & Kinzua Ry. Co., N. Y. L. J., Jan. 26, 1897.

[2] O'Beirne *v.* A. & K. R. Co., 151 N. Y. 372.

[3] Central Electric Co. *v.* La Grande Edison Electric Co. (1897), 79 Fed. Rep. 25.

[4] Young *v.* Montgomery & Eufaula R. Co. (1875), 2 Woods, 606, 612.

[5] Indiana, Ill. & Iowa R. Co. *v.* Swammell, Execr. *et al.* (1895), 157 Ill. 616; s. c. 41 N. E. Rep. 989, affirming Same *v.* Same, 54 Ill. App. 260 (1894).

[6] Farmers' Loan & Trust Co. *v.* Northern Pac. R. Co. (1895), 70 Fed. Rep. 423, following Farmers' Loan & Trust Co. *v.* Northern Pac. R. Co. (1895), 66 Fed. Rep. 169; Clyde *v.* Richmond & Danville R. Co. (1893), 55 Fed. Rep. 445, disapproved.

[7] Richter *v.* Jerome (1887), 123 U. S. 246; s. c. 8 Sup. Ct. Rep. 233, 246; s. c. 7 Sup. Ct. Rep. 807; Kerrison *v.* Stewart (1876), 93 U. S. 155, 160; Corcoran *v.* Chesapeake & Ohio Canal Co. (1876), 94 U. S. 741, 745; Shaw *v.* Railroad Co. (1879), 100 U. S. 605, 611.

good faith and without collusion, if what they ask is not inconsistent with the provisions of the trust,[1] his decision is not final or conclusive upon the bondholders. Where different sets of bondholders, as represented by their committees, differ as to a manner of sale of the property, for instance, or the distribution of the assets, they should be allowed to intervene so as to be heard by the court before a decree is made.[2]

A minority bondholder's bill to foreclose a mortgage will be sustained where the road of the mortgagor is controlled and operated by another company which owns more than one-fourth of the stock and bonds of the mortgagor, notwithstanding the requirement of the mortgage that the request of one-fourth of the bondholders was necessary to a foreclosure, especially when his bill seeks an accounting from the company operating the road, alleging that the latter has diverted the earnings of the mortgagor and appropriated them to his own use, and caused the insolvency of the mortgagor, and the examination of its books is either denied him or they are inaccessible to him.[3]

§ 463. **The Assignment of the Bonds by way of Collateral Security.** — This does not deprive the pledgor of his right to maintain a suit in behalf of himself and the other bondholders for the protection of their joint interests in the mortgaged property.[4] But in such a case the pledgee should also be a party.[5]

The pledgee of bonds, on the other hand, may also institute proceedings for the foreclosure of the mortgage by which they are secured.[6] But the owner of the bonds should also be made a party.[7]

§ 464. **Who are Necessary Parties Defendant.** — This question in a suit affecting the mortgaged property depends upon the nature

[1] First Nat. Bank of Cleveland *v.* Shedd (1884), 121 U. S. 74, 86; s. c. 7 Sup. Ct. Rep. 807.

[2] Farmers' Loan & Trust Co. *v.* Cape Fear & Y. V. Ry. Co. *et al.* (1895), 71 Fed. Rep. 38. See Williams *v.* Morgan, 111 U. S. 684; s. c. 4 Sup. Ct. Rep. 638.

Where the equity of redemption in one of several mortgages had been purchased by a company limited, which company had issued debentures to a large amount, which were a charge upon the mortgaged property, the English court held that all the debenture-holders, having an interest in the equity of redemption, should be made parties to a foreclosure action. Griffith *v.* Pound (1889), 45 Ch. Div. 553.

A holder of railway bonds sued a company, as he alleged, on behalf of himself and other bondholders. A bondholder appeared and petitioned, as he and others dissented from this action of the plaintiff, that he be made a party defendant, which was allowed. Fraser *v.* Cooper, Hall, & Co. (1882), 21 Ch. Div. 718.

[3] Linder *v.* Hartwell R. Co. *et al.* (1896), 73 Fed. Rep. 320.

[4] Butler *v.* Rahm (1877), 46 Md. 541; s. c. 18 Am. Ry. Rep. 86.

[5] Wiltsie on Mortgage Foreclosure, §§ 87, 88, and authorities cited.

[6] McCurdy's Appeal (1870), 65 Pa. St. 290; Morton *v.* New Orleans & Selma R. Co. (1885), 79 Ala. 590.

[7] Ackerson *et al.* *v.* Lodi Branch R. Co. (1877), 28 N. J. Eq. 542.

and extent of the relief asked. If the proceedings are for foreclosure of the mortgage, it is obvious that where the complainant merely wishes to extinguish the equity of redemption which the mortgagor possesses under the mortgage to be foreclosed, the mortgagor himself is, strictly speaking, the only necessary party defendant.[1]

But in practice a foreclosure suit of such unlimited scope is unknown. Wherever there are several antagonistic liens upon the mortgaged property, the invariable object of such a proceeding is to cut off all subordinate liens, and thus offer for sale a title as free from incumbrances as the case admits. Necessary parties, therefore, are those who must be joined in order to attain that object.[2]

But the mortgagor company is not a necessary or proper party in a suit brought to reach and adjust rights which accrue upon a foreclosure of the mortgage. The rights of the company having been extinguished by the sale, it has no interest in the corporate property to defend or protect, nor can any relief against it be had in respect to that property.[3]

§ 465. **Prior Mortgagee, when a Necessary Party.**—A prior mortgagee is not a necessary party when the decree cannot injure or affect him. "It can never be indispensable to make defendants of those against whom nothing is alleged, and from whom no relief is asked."[4]

Hence a prior mortgagee is not a necessary party where a bill is filed by a junior mortgagee seeking only a foreclosure or sale of the equity of redemption. This rule prevails in the Supreme

[1] Wabash, St. Louis, & Pac. R. Co. *v.* Central Trust Co. (1885), 23 Fed. Rep. 513, 514, in which the following pertinent remarks were made by Judge Brewer:—

"In the foreclosure of a mortgage there is a certain sense in which you may say that the only indispensable parties are the mortgagor and the mortgagee. You can foreclose that mortgage and divest the mortgagor of all his interest, and transfer it by sale into the mortgagee or any other purchaser, and that without the presence of other incumbrancers as parties. And yet we all know that there are certainly proper parties, or may be proper parties, other than the mortgagor and mortgagees. Subsequent mortgagees, of course, are proper parties, in order to cut off any equity of redemption; and while it is laid down in the Supreme Court of the United States that an independent controversy between the mortgagor and a third party, one involving the question of paramount title, is not to be litigated in a foreclosure suit, yet all those things which simply involve matters of liens on the property, whether prior or not, may be considered in such a suit."

[2] Wiltsie in his work on Mortgage Foreclosures criticises, very justly, in our opinion, the extreme looseness with which the word "necessary" is often used in this connection by the courts. See also Pomeroy Rem., § 329.

[3] Brooks *v.* Vermont Central R. Co. (1884), 22 Fed. Rep. 211.

[4] Payne *v.* Hook (1868), 7 Wall. 425, 432.

Court of the United States,[1] and in all other courts of equity both in this country and in England. In Manitoba it was recently held that mortgagees holding the first lien on a railway company and its revenues are not proper parties in a judgment creditors' action, and the inquiry should be confined to subsequent incumbrancers.[2] If the State is the prior lienor, this rule will, of itself, be a sufficient ground for dismissing a demurrer to a bill for foreclosure, based on the omission to make the State a party defendant, though such omission may also be justified on account of the impossibility of making the State a party against its consent.[3]

In a suit for an accounting brought against the trustees by the bondholders, it is equally unnecessary to make the claimant of a prior lien upon the trust fund a party to the proceedings.[4]

When the prior mortgage is not due, an additional reason exists for holding the owner of such a mortgage not to be a necessary party to a foreclosure suit brought by a subsequent mortgagee, for in that case nothing more than the equity of redemption under the later mortgage could be sold without the consent of the prior mortgagee.[5] A contrary doctrine would be equivalent to holding that a prior mortgagee might be compelled to foreclose his lien before the maturity of the debt, a theory inconsistent with the paramount character of that lien.[6]

If the prior mortgage is due, its holder may be compelled to surrender it upon being tendered the sum due thereon.[7]

On the other hand, a prior mortgagee is a proper party to bill for foreclosure, which asks at the same time that a receiver be appointed, and that the net revenues of the receivership be paid to such persons as the court should adjudge to be entitled to them. The priority of the earlier mortgagee should be admitted and no direct relief asked against him.[8]

The reason of this qualification of the general rule is that the effect of the appointment of a receiver is to defeat the power

[1] Jerome *v.* McCarter (1877), 94 U. S. 734; Woodworth *v.* Blair (1884), 112 U. S. 8; Hanna *et al.* *v.* State Trust Co. *et al.* (1895), 70 Fed. Rep. 2, 7; s. c. 16 C. C. A. 586.

[2] Allan *v.* The Manitoba & N. W. Ry. Co. (1894), 10 Manitoba, 106. See Grey *v.* Manitoba & N. W. Ry. Co. (1897), L. R. App. Cas., p. 254.

[3] Kelly *v.* Trustees of Alabama & Cincinnati R. Co. (1880), 58 Ala. 489; s. c. 21 Am. Ry. Rep. 138.

[4] Andrews *v.* Smith (1881), 19 Blatch. 100; s. c. 5 Fed. Rep. 833, 845.

[5] Jerome *v.* McCarter (1877), 94 U. S. 734.

[6] Siebert *v.* Minneapolis & St. Louis R. Co. (1888), 52 Minn. 148; s. c. 53 N. W. Rep. 1134.

[7] Lambertville National Bank *v.* McCready Bag & Paper Co. (N. J. Eq., 1888), 1 Law Rep. Ann. 334.

[8] Miltenberger *v.* Logansport Ry. Co. (1882), 106 U. S. 286, 306.

of those trustees to take possession of and operate the road, as the deed authorizes them to do.[1]

So, also, a prior mortgagee should be made a party where the junior mortgagee is endeavoring to obtain a sale of the entire property or estate, and not merely of the equity of the redemption;[2] or where there are real doubts respecting the amount of the debt due to the prior lienor.[3]

The grantee of a trust deed alleged to be prior to the mortgage in suit should be made a party to the suit if the defendant so desires, as he has a right to have the question of the priority determined in the proceedings.[4]

Senior mortgagees will not be allowed to become parties to an action for the foreclosure of a junior mortgage and contest the accuracy of the judgment rendered therein. If their rights are in any way impaired, they should bring a separate action through their trustees, or, if the trustees are hostile, in their own names.[5]

Where the prior mortgagee is improperly made a party, the usual course is to dismiss the bill as to him, and retain it as to all the other parties;[6] and if a subsequent mortgagee or other incumbrancer brings in a prior mortgagee as a party, for the purpose of ascertaining the priorities of the different lienors, and does not offer to redeem the prior incumbrance, the prior mortgagee may insist upon being dismissed with costs.[7]

In foreclosure proceeding instituted by a junior mortgagee, the prior mortgagee can be made a party only by service of process or voluntary appearance. A general notice calling upon him to present his claims will not make him a party, nor bind him;[8] in all cases in which he is not made a party, the sale is made subject to the lien of his mortgage.[9]

His rights, not being prejudiced in any way by such proceedings, an order will not be granted making him a party to such proceed-

[1] Tome *v.* King (1891), 64 Md. 166; s. c. 21 Atl. Rep. 279.

[2] Jerome *v.* McCarter (1877), 94 U. S. 734.

[3] Jerome *v.* McCarter (1877), 94 U. S. 734; Sutherland *v.* Lake Superior Ship Canal, Railroad, & Iron Co. (1874), 2 Flip. 449; s. c. 9 N. B. R. 298; Richards *v.* Chesapeake & Ohio R. Co. (1875), 1 Hughes, 28; Metropolitan Trust Co. *v.* Tonawanda Valley & Cuba R. Co. (1887), 43 Hun, 521.

[4] Baass *v.* Chicago & Northwestern Ry. Co. (1876), 39 Wis. 296.

[5] McHenry's Petition (1878), 9 Abb. N. C. (N. Y.) 256.

[6] Wabash, St. Louis, & Pac. Ry. Co. *v.* Central Trust Co. (1884), 22 Fed. Rep. 138, 144.

[7] Daniell's Ch. Pr. 1390; Tome *v.* King (1891), 64 Md. 166; s. c. 21 Atl. Rep. 279.

[8] Young *v.* Montgomery R. Co. (1875), 2 Woods, 606, 620.

[9] Ibid.

ings, and allowing him to contest the accuracy of the judgment entered therein, there being nothing to show him that the sufficiency of his security has been impaired by the judgment.[1]

The holder of a mortgage, filing a bill to foreclose the same, need not make other mortgagees parties; the rights of those whose mortgages have precedence over his he cannot disturb, and this bill will affect the rights of only such subsequent mortgagees as he makes parties to his suit: they are proper, but not necessary, parties.[2]

§ 466. **Subsequent Mortgagees, Necessity of joining.**[3] — From the general principle noticed above, that the question whether there are any necessary parties defendant omitted depends upon the object of the suit, it follows that, wherever the intention of the complainant is to clear the title of incumbrances as far as is possible, having due regard to the paramount rights of prior lienors, every holder of a lien subsequent to that which is being foreclosed must be made a party, in order that his rights may be determined by the decree. In other words, such a lienholder is always a proper, but is never an indispensable, party.[4]

If he is not made a party, his right to redeem is unaffected by the decree;[5] and this right passes to one who purchases at a sale in foreclosure proceedings afterwards instituted by such junior lienholders.[6]

Even though the junior mortgagee be made a party to the suit, the terms of the decree may show that it was not intended to cut off his lien; and unless his rights are actually determined, the mere fact that he was made a party does not estop him from afterwards asserting those rights and redeeming from the foreclosure sale.[7]

[1] McHenry's Petition (1878), 9 Abb. N. C. (N. Y.) 256.

[2] Chandler *v.* O'Neil, Delany, & Murphy (a corporation), 62 Ill. App. 418 (1895).

[3] See generally on this subject a useful collection of cases in the notes to 1 Lawyers' Rep. Ann. 334; 3 Am. & Eng. R. R. Cas. 530; 12 Am. & Eng. R. R. Cas. 329.

[4] Forrest's Exrs. *v.* Luddington (1880), 68 Ala. 1; s. c. 12 Am. & Eng. R. R. Cas. 330, and the full list of cases cited in the notes to Jones on Mortgages, § 1425, and Wiltsie on Mortgage Forecl., § 188. To these works reference must be made for fuller information as to the application of the general rule.

[5] Jones on Mortg., § 1431; Wiltsie on Mortg. Forecl., § 160.

[6] Memphis & Little Rock R. Co. as reorganized *v.* The State (1881), 37 Ark. 632; s. c. 12 Am. & Eng. R. R. Cas. 322.

[7] Simmons *v.* Taylor (1885), 23 Fed. Rep. 849. In regard to the question of estoppel, Judge Brewer expressed his views as follows: —

"A second mortgagee is not bound to insist upon a foreclosure of his mortgage. It matters not whether the first mortgagee forecloses or not. The second mortgagee owes no duty to anybody to act. If the first mortgagee wishes to cut off his equity of redemption, it is the duty of such first

If the trustee of a subsequent mortgage has been made a party to a foreclosure suit, and it is found that his being a party to the litigation will hinder or defeat the suit, the bill will be dismissed as to him.[1]

§ 467. — **Mortgagee of Divisional Mortgages.** — Such mortgagee is not a necessary party in a foreclosure suit brought by another divisional mortgagee, whose lien operates upon an entirely distinct portion of the road.[2]

§ 468. **Mortgagor Company.** — A company which, during the pendency of such a bill, takes from the operating company, as its successor, the bonds of the mortgagor company, after their maturity, will stand in the shoes of the original defendant company.[3]

§ 469. **The Stockholders.** — The stockholders of the company are sufficiently represented in a suit brought by the holders of municipal bonds, which the company has guarantied, to enforce the priority of a claim as against the stockholders to the proceeds of the foreclosure sale, where not only the company itself, but the committee appointed by the stockholders and bondholders, are made parties to the proceedings.[4]

The proper party to impeach the legal title of the purchaser by impressing a trust upon the property in favor of the company, as against the purchasers at a foreclosure sale, is not a single stockholder, but the corporation which represents the whole body of stockholders.[5] And since the stockholders, being an integral part of the corporation, are regarded as parties to proceedings involving the corporation, they are bound by the decree entered in such

mortgagee to make him a party, and to take a decree against him; and if he fails to do that, the second mortgagee is not concluded. The mere fact that he is made a party casts no obligations upon him. He may remain silent, and if no decree is taken against him, his rights remain as though he had not been made a party. No one would pretend that, if not made a party, his rights are cut off by his mere failure to come into court and ask to be made a party. And afterwards in all proceedings by the first mortgagee the second mortgagee stands on the defensive. His rights are perfect, unless at the instance of the first mortgagee they are affirmatively cut off, or lost through the running of the Statute of Limitations." In this case the grounds assigned by Judge Brewer for his conclusion that there was no foreclosure of the mortgage by the decree were that the claim of the second mortgagee was not barred in terms, that there was no finding of the amount due to him, nor any order of sale to satisfy his lien, nor in fact any reference to that lien except a simple reference for future determination by the court of so much of its claim as asserted a first lien upon specific personal property.

[1] Richards *v.* Chesapeake & Ohio R. Co. (1875), 1 Hughes, 28.

[2] Bronson *v.* Railroad Company (1862), 2 Black, 524.

[3] Linder *v.* Hartwell R. Co. *et al.* (1896), 73 Fed. Rep. 320.

[4] Railroad Company *v.* Howard (1869), 7 Wall. 392.

[5] Harpending *v.* Munson (1883), 91 N. Y. 650, 653; s. c. 12 Am. & Eng. R. R. Cas. 408.

proceedings, and cannot impeach it collaterally on the ground of fraud.[1]

Stockholders, on allegations that the directors of a railroad company, for the purpose of sacrificing the interest of the stockholders, refuse to defend a foreclosure suit, will be allowed to intervene and become parties defendant, so as to protect their own interests and those of other stockholders choosing to join them in the defence.[2]

§ 470. **Directors.** — The directors of a construction company to whom bonds and stock are alleged to have been fraudulently transferred are proper parties, with a view to a discovery, in a suit in which the complainant, besides asking for another relief, insists that those bonds should be surrendered.[3]

§ 471. **Guarantors.** — The guarantor of the bonds, who afterwards joins the mortgagor in borrowing money to pay the interest coupons, does not thereby become subrogated *pro tanto* to the rights of the mortgagee, so as to become an indispensable, or even proper, party to a subsequent foreclosure suit. Subrogation does not take place until the payment of the whole debt for which the security is liable.[4]

§ 472. **Receivers.** — When a foreclosure suit is instituted after the appointment of a receiver, he is a proper, though not necessary,[5] party defendant therein. Still less is it necessary to make him a party to a suit already begun in another court when he was appointed;[6] especially when a decree *pro confesso* has already been taken in the earlier suit, by which the right of the complainant to recover has been ascertained.[7]

[1] Graham *v.* Boston, Hartford, & Erie R. Co. (1886), 118 U. S. 161; s. c. 6 Sup. Ct. Rep. 1009; 25 Am. & Eng. R. R. Cas. 53. Compare Great Western Tel. Co. for Use, etc. *v.* Gray (1887), 112 Ill. 630; s. c. 14 N. E. Rep. 214.

[2] Guarantee Trust & Safe Deposit Co. *v.* Duluth & Winnipeg R. Co. *et al.* (1895), 70 Fed. Rep. 803, on authority of Bronson *v.* Railroad Co. (1864), 2 Wall. 302.

[3] Terhune *v.* Midland R. Co. of New Jersey (1884), 38 N. J. Eq. 423; s. c. 38 Am. & Eng. R. R. Cas. 665.

[4] Columbia Finance & Trust Co. *v.* Kentucky Union R. Co. (1894), 60 Fed. Rep. 794. As to when a guarantor should be joined, see generally Jones on Mortg., § 1432.

[5] Raynor *v.* Selmes (1873), 52 N. Y. 579; Kirkpatrick *v.* Corning (1884), 38 N. J. Eq. 234; Herring *v.* New York, Lake Erie, & Western R. Co. (1887), 105 N. Y. 340.

[6] Mercantile Trust Co. *v.* Pittsburgh & W. R. Co. (1887), 29 Fed. Rep. 732.

[7] Willink *v.* Morris Canal & Bkg. Co. (1843), 4 N. J. Eq. 377. There the court said, in reply to the contention that the receivers should be joined as defendants (p. 400): "The title to the property is not changed, but a power only is delegated to the receivers to take charge of it and sell it. These receivers, too, may bring suits in their own name, and, for aught I see, in the name of the corporation, should they prefer it; and if so, they may defend a suit in the name of the corporation. As a decree *pro confesso* in this cause was taken against this company before the receivers were appointed, by which the right of the com-

If the receiver should ask to be made defendant, with a view to making a defence, the court will permit him it at any stage of the proceedings.[1]

A receiver is, to the extent of his interest, a proper party to a suit instituted by a stockholder in the mortgagor company to have certain bonds held by the receiver in his official capacity declared *ultra vires* and illegal.[2]

After the receiver has ceased to exercise his functions, and the property has passed out of his control by a sale under the decree of a State court, he is not a necessary party to a suit brought in a federal court to have the proceedings in the State court avoided on the ground that they were collusive and fraudulent.[3]

§ 473. **States as Parties Defendant.** — The general rule is that the State cannot be made a party to a suit without its consent. For this reason an injunction against the sale of a railroad to satisfy the lien of the State, imposed upon the property of a railroad company to indemnify it for its indorsement of the company's bonds, will be refused to the holder of a portion of a subsequent issue of such bonds, which had recently been declared not binding upon the State. Under such circumstances the relief cannot be given without passing upon the rights of the State, and this would necessitate the joinder of the State as a party.[4]

Such a case is to be distinguished from those in which the courts have sustained suits against State officers for the recovery or protection of property belonging to the complainants, in which the State has no interest or right; and the pretension of the agents in behalf of the State were unconstitutional and void.[5]

But if the State is the real party in interest, the operation of

plainant to recover is ascertained, and the amount only remains to be settled, and more especially as the corporation is not put an end to by this act of the court, and the receivers may appear and controvert the amount in the name of the corporation, I see no good reason why the proceedings in this cause should be delayed to bring them before the court."

[1] Willink *v.* Morris Canal & Bkg. Co. (1843), 4 N. J. Eq. 377.

[2] Central Trust Co. *v.* Wabash, St. Louis, & Pac. Ry. Co. (1885), 23 Fed. Rep. 858.

[3] Massachusetts Mutual Life Ins. Co. *v.* Chicago & A. R. Co. (1882), 13 Fed. Rep. 857.

[4] Branch *v.* Macon & Brunswick R. Co. (1875), 2 Woods, 385, 388, per Bradley, J., who said: "The State was here in possession of this property, and rightfully so. The object of this bill could not be effected except by displacing the State, and subrogating the bondholders in its stead in reference to this property, and dispossessing the State of the actual possession of the same." In deciding that such dispossession was not allowable, the learned justice deferred to the opinion of the court of the State in which he was sitting. Printup *v.* Cherokee R. Co. (1872), 45 Ga. 365.

[5] Branch *v.* Macon & Brunswick R. Co. (1875), 2 Woods, 385, 388. See also the authorities cited in the opinion of Justice Miller in Cunningham *v.* Macon & Brunswick R. Co. (1883), 109 U. S. 446.

the general rule cannot be evaded by making the State officers the nominal parties.[1]

On the other hand, the mere fact that the State cannot be sued is no reason why holders of bonds indorsed by the State should not be subrogated to the rights of the State, and have the benefit of the security. In a suit by them to enforce the lien thus imposed for their benefit, the State should be joined, if that can be done, for the reason that it is concerned in the subject-matter in the proceedings; but its non-amenability to suit is a sufficient reason for not joining it as a party.[2]

Still stronger reasons exist for permitting the bondholders to assert their claims under such circumstances where the State has disclaimed its rights in respect to the enforcement of the statutory lien, and disavowed all liability for the payment of the bond. The State, when a lien is declared in its favor to indemnify it for its indorsement of corporate bonds, is not merely a beneficiary of the lien, but stands also in the relation of a trustee in respect to the

[1] Printup *v.* Cherokee Railroad Co. (1872), 45 Ga. 365; Cunningham *v.* Macon & Brunswick R. Co. (1878), 3 Woods, 418, affirmed in Cunningham *v.* Macon & Brunswick R. Co. (1883), 109 U. S. 446. This case was an attempt to get over the difficulty which had proved fatal to the claims set up in Branch *v.* Macon & Brunswick R. Co. (1875), 2 Woods, 385. In the Supreme Court Justice Miller exposed the unsoundness of the complainant's position thus: "No foreclosure suit can be sustained without the State, because she has the legal title to the property, and the purchaser under the foreclosure decree would get no title in the absence of the State. The State is in the natural possession of the property, and the court can deliver no possession to the purchaser. The entire interest adverse to the plaintiff in this suit is the interest of the State of Georgia, in the property of which she has both the title and possession." Cunningham *v.* Macon & Brunswick R. Co. (1883), 109 U. S. 446, was fully approved in Christian *v.* Atlantic & North Carolina R. Co. (1890), 133 U. S. 233, where the holder of certain aid-bonds issued by the State of North Carolina sought to have the dividends, due upon the railroad stock purchased by the State with the proceeds of the bonds, applied to the payment of the interest on the bonds, — the company, the person holding the proxy of the State, and the treasurer of the State being made parties defendant to the bill. The court dismissed the bill, taking occasion to remark that anything which appeared to countenance the possibility of such a suit in Swasey *v.* North Carolina R. Co. (1873), 1 Hughes, 17, was bad law. In Murdock *v.* Woodson (1873), 2 Dill. 188, Judge Dillon held that the Governor and Attorney-General of the State of Missouri might be made parties defendant in a suit by the trustee of a railroad mortgage to enjoin the sale of the road for the satisfaction of an earlier statutory mortgage in favor of the State. The State in this case was said to be asserting merely the right of the creditor or lienholder, and not any right in her sovereign character. The precedent most relied upon was Davis *v.* Gray (1873), 16 Wall. 203, 215; but after the criticism upon this decision in Cunningham *v.* Macon & Brunswick R. Co., *supra*, it seems questionable whether the doctrine of Murdock *v.* Woodson can now be accepted without some qualification.

[2] Young *v.* Montgomery & Eufaula R. Co. (1875), 2 Woods, 606; Kelly *v.* Trustees of Alabama & Cincinnati R. Co. (1880), 58 Ala. 489; s. c. 21 Am. Ry. Rep. 138.

holders of the bonds. The failure of the State to execute the trust by enforcing the lien brings into play the principle that a court of equity will not suffer a trust to fail because of the want of a trustee to execute it. The enforcement of such a lien does not require any decree or judgment against the State, and therefore the freedom of the suit attaching to its sovereignty is a sufficient reason for dispensing with its presence as a party.[1]

§ 474. **The United States as a Party Defendant.** — The rule that a sovereign body cannot be made a party without its consent applies to the United States also.[2]

§ 475. **If a State or the United States become Parties to a Suit, they are as much bound by the Decree as the other Parties.**[3]

§ 476. **Intervention of Parties materially interested.** — The principle that all those who are materially interested in the subject of the suit must be brought before the court, if the decree will affect their rights, involves the corollary that, if any such persons are not joined, they may be made parties on their own motion. Thus judgment creditors who assert their lien to be superior to that of a mortgage may intervene in a suit to foreclose it, and contest its priority.[4]

A simple contract creditor may intervene in a foreclosure suit if he has any equities in respect to the property, whether prior or subsequent to those of the complainant, and can secure their determination and protection.[5]

Rival creditors may contest the validity of their claims and the priority of their respective liens in foreclosure suits, but in subordination to the general object and purpose of the suit in which they are allowed to intervene, and not to defeat that object and purpose, or to interpose obstacles to the progress of the suit.[6]

[1] Forrest's Exrs. *v.* Luddington (1880), 68 Ala. 1; s. c. 12 Am. & Eng. R. R. Cas. 330. A similar decision was made in Stewart *v.* Chesapeake & Ohio Canal Co. (1880), 1 Fed. Rep. 361.

[2] Case *v.* Terrell (1870), 11 Wall. 199; Carr *v.* United States (1878), 98 U. S. 433, 437; Hawes on Parties, § 40. In Meier *v.* Kansas R. Co. (1877), 4 Dill. 378, the method by which the United States was made a party was by directing a notice, under the seal of the court, to the Attorney-General of the United States, stating that a suit had been instituted against the United States, and requesting him to appear. For other suggested methods, see Hawes on Parties, § 11.

[3] Hand *v.* Savannah & Charleston R. Co. (1880), 13 S. C. 467; United States *v.* Flint (1876), 4 Sawyer, 58.

[4] Scott *v.* Mansfield, Coldwater, & Lake Michigan R. Co. (1877), 2 Flip. 15. The court expressly said that to allow this intervention was simply the enforcement of the general practice in chancery of making all lienholders defendants, where one of them brings suit upon his own lien.

[5] Lombard Inv. Co. *et al. v.* Seaboard Manufg. Co. (1896), 74 Fed. Rep. 325, 326; Hollins *v.* Brierfield Iron & Coal Co. (1893), 150 U. S. 371; s. c. 14 Sup. Ct. Rep. 127.

[6] Forbes *v.* Memphis, El Paso, & Pac. R. Co. (1872), 2 Woods 323; s. c. 9 Fed. Cas. 408, No. 4926.

Such intervention, however, is not permissible in the case of a general creditor having no specific lien, especially where the cause has passed to an appellate court.[1]

Where, in a foreclosure suit, the company has answered and been represented by the counsel of the trustee, and consented to a receivership and a decree by which the receiver is authorized to take possession of all the company's personal property not covered by the mortgage, thus shielding it from the general creditors, such a decree will be treated as a void and collusive one to that extent; and while general creditors might intervene in the foreclosure suit, it is their right instead to file an original bill to have the property not covered by the mortgage administered for their benefit by an extension of the receivership in the foreclosure suit to a receivership in their bill.[2]

(As to intervention of parties in interest who are not formal parties to suits instituted by individual bondholders or the trustee, see Art. II., *post.*)

Article II. — Parties in Suits by or against the Trustees or Representative Bondholders.

§ 477. **Introductory.** — The operation of the subsidiary rule of equity practice, that numerous parties having a common interest may be represented in a suit affecting that interest by one or more of their number, and when so represented are bound by the action of their representative, whether the suit is brought by or against them,[3] may, for the purposes of the present treatise, be conveniently considered in its application (1) to cases in which one or more of the bondholders act as representative of the rest; (2) to cases in which the bondholders as a body are represented by the trustee named in the mortgage, or substituted in one of ways already discussed in Chapter VII., above.

§ 478. **Representation of Bondholders by one or more of their Number.** — It is well settled that the bondholders secured by a trust mortgage in the usual form may themselves set the machinery of the law in motion for the protection of their interests, making the trustees defendants whenever the trustees have either refused to institute a suit for that purpose,[4] or have been guilty of some

[1] Bronson v. Railroad Company (1862), 2 Black, 524.

[2] Alabama Nat. Bank v. Mary Lee Coal & Railway Co. *et al.* (Ala.), 19 So. Rep. 404 (1896).

[3] See generally Daniell's Ch. Pr., pp. 238 *et seq.*, and pp. 278 *et seq.*

[4] Alexander v. Central Railroad of Iowa (1874), 3 Dill. 487; s. c. 1 Fed. Cas. 363, Case No. 166; Coal Co. v. Blatch-

active misconduct,[1] or have acquired interests adverse to those of the bondholders, and are consequently incapable of maintaining the rights of the latter without attacking their own.[2]

The same right of independent suit necessarily exists for the bondholders when the removal of the trustee is the object of the suit, or where it is sought to obtain the appointment of new trustees after the original ones have abandoned their trust.[3]

In proceedings instituted by individual bondholders in any of the allowable cases just mentioned, one or more of their number may sue for the benefit of the whole body,[4] such representative or representatives being under the obligation of acting with the utmost fairness and good faith in procuring a final decree, which is to be binding upon all parties in interest.[5]

Several classes of bondholders may properly be represented by persons who hold bonds of the different classes. This fact does

ford (1870), 11 Wall. 172; Weetgen *v.* Vibbard (1875), 5 Hun, 265; Campbell *v.* Railroad Co. (1871), 1 Woods, 368; First National Fire Ins. Co. *v.* Salisbury (1881), 130 Mass. 303; s. c. 4 Am. & Eng. R. R. Cas. 480; De Betz's Petition (1878), 9 Abb. N. C. 246; Owens *v.* Ohio Central R. Co. (1884), 20 Fed. Rep. 10, 13; Beekman *v.* Hudson River West Shore R. Co. (1888), 35 Fed. Rep. 3; Seibert *v.* Minneapolis & St. L. R. Co. (1893), 52 Minn. 148; s. c. 53 N. W. Rep. 1134; 57 Am. & Eng. R. R. Cas. 208; Chicago & Vincennes R. Co. *v.* Fosdick, 106 U. S. 47, 68; s. c. 7 Am. & Eng. R. R. Cas. 427; Barry *v.* Missouri, K. & T. R. Co. (1886), 27 Fed. Rep. 1; s. c. 36 Fed. Rep. 228 (1888); Central Trust Co. *v.* Charlotte, C. & A. R. Co. (1895), 65 Fed. Rep. 264; McFadden *v.* May's Landing & Egg Harbor City R. Co. (1891), 49 N. J. Eq. 176; Beden *v.* Burke (1893), 72 Hun, 51.

A provision in the mortgage that no independent action to foreclose shall be brought by a bondholder, until the trustee has refused to comply with the requisition of a certain percentage of the bondholders, is reasonable and valid. Seibert *v.* Minneapolis & St. Louis R. Co. (1893), 52 Minn. 148; s. c. 53 N. W. Rep. 1134; 57 Am. & Eng. R. R. Cas. 208. The bill of a bondholder who brings suit to enforce any of his rights under the mortgage must allege the refusal or neglect of the trustee to institute proceedings, or such other cause as is relied on to justify his claim to become *dominus litis*, and if the answer of the railroad company is such as to make the unfitness of the trustee an issue in the case, and he neither appears voluntarily nor is served with process, the bill will be dismissed. Morgan *v.* Kansas Pacific Ry. Co. (1882), 15 Fed. Rep. 55; Barry *v.* Missouri, K. & T. Ry. Co. (1884), 22 Fed. Rep. 631.

1 Weetjen *v.* Vibbard (1875), 5 Hun, 265; Western Railroad Co. *v.* Nolan (1872), 48 N. Y. 513; Central Trust Co. *v.* Charlotte, C. & A. R. Co. (1895), 65 Fed. Rep. 264.

2 Webb *v.* Vermont Central R. Co. (1881), 9 Fed. Rep. 793; American Tube, etc. Co. *v.* Kentucky, etc. Co. (1893), 52 Fed. Rep. 826.

3 Stevens *v.* Eldridge (1876), 4 Cliff. 348.

4 Campbell *v.* Railroad Co. (1871), 1 Woods, 368; Wilmer *v.* Atlanta & Richmond Air Line Ry. Co. (1875), 2 Woods, 447; March *v.* Eastern R. Co. (1862), 40 N. H. 548; Mason *v.* York & Cumberland R. Co. (1861), 52 Me. 82; Farmers' Loan & Trust Co. *v.* Winona & S. W. Ry. Co. (1893), 59 Fed. Rep. 957.

5 Campbell *v.* Railroad Co. (1871), 1 Woods, 368.

not constitute such an antagonism of interest as to prevent the application of the usual rule.[1]

§ 479. **Bondholder allowed to sue when Trusteeship of Foreign Corporation is vacant.** — Where the subject-matter of the suit lies in one State, and the mortgagor corporation was organized in another, a court in the former State will not compel a person holding a majority of the bonds to apply to the courts of the latter to fill a vacancy in the office of trustee, but will allow such bondholder to carry on a foreclosure suit in his own name. Especially will this course be allowed when the trust deed expressly provides that the remedies therein specified are "cumulative to all other remedies allowed by law, and that the same shall not be deemed in any manner whatever to deprive the trustee or the beneficiaries under the trust of any legal or equitable remedy by judicial proceedings."[2]

§ 480. **Bondholder allowed to sue when Trustee is Non-resident.** — One of two bondholders protected by a trust mortgage may bring an action for the foreclosure of the mortgage in his own name, where the trustee is absent in a foreign country, and the bondholder has sufficient reason to believe that he has become insane.[3]

§ 481. **Suit by Representative Bondholder, when not permissible.** — Where the mortgage is executed to the bondholders by name,

[1] Galveston Railroad *v.* Cowdrey (1871), 11 Wall. 459, 478. The court said (pp. 478, 479): "They are no more antagonistic to each other than the several bondholders of the same class are. It is the interest of each bondholder to have as few prior claims to his, and as few participants with him, as possible. Every co-bondholder is in one sense an antagonist. But the objection is entirely without foundation. The complainants do, in fact, hold bonds of the three different classes, and they have a perfect right to state that fact in their bill, and to ask for relief suitable to the fact, and no possible harm or inconvenience can arise in their suing in behalf of themselves and all other bondholders in each class according to their several priorities. If any class of bondholders wish to contest the precedence of a prior mortgage they have a perfect right to intervene in the suit, and file a cross-bill setting up the objection." The court then referred to the doctrine laid down by Judge Story (Eq. Pl., § 158), that it is sufficient, in a suit by incumbrancers, to file the bill on behalf of all the creditors and incumbrancers, thus making them all, in a sense, parties to the extent of asserting their own rights, or of enabling them to contest the matter before a master, and proceeded thus: "But the case before us is much stronger than this. The complainants *must* set out their own claims under the different mortgages, and it would be impossible to make all the bondholders of either class parties, for they could not be discovered; and the rights of all are protected by the opportunity given to all to contest the claim of any."

[2] Wheelwright *v.* St. Louis, N. O. & O. Canal Transportation Co. (1893), 56 Fed. Rep. 164.

[3] Ettlinger *v.* Persian Rug & Carpet Co. (1894), 142 N. Y. 189; s. c. 36 N. E. Rep. 1055.

and expressly declares the interest of each of them, it comes under the rule that a suit upon a written instrument must be brought in the name of all who are formal parties thereto and retain an interest therein; and if a single one of the bondholders secured by such a mortgage brings suit to foreclose it, the bill will be dismissed for defect of parties.[1] Nor is it competent for one of several joint owners of bonds, without joining the other owners as plaintiffs, to institute a suit thereon, the purpose of which is to upset judicial decrees, charge trusts, and fasten supposed liens in consequence of joint interests. Since the decree in such a suit must be for the benefit of all, and binding upon all, the real parties in interest must appear. The fact that the bonds are payable to bearer, and that the plaintiff has manual possession of them, does not entitle him to maintain the suit.[2]

§ 482. **Participation of Bondholders in Suit begun by a Portion of their Number.** — Where a suit is brought upon an ordinary trust mortgage by any number of the bondholders less than the whole, it is not necessary that the others should be joined as parties, either plaintiff or defendant; for their interests are represented not only by the complainants, but by the trustee, who is necessarily made a party defendant (see above). They may, however, come in at any stage of the proceedings, and become parties plaintiff, or they may propound their claims before a master.[3]

The privilege of intervention is open to them even after the suit has passed to the appellate court and been remanded to the lower court.[4]

An order made in a federal court allowing all the bondholders to come in and be made complainants in a suit instituted by a bondholder must be limited to bondholders who are not citi-

[1] Railroad Co. *v.* Orr (1873), 18 Wall. 471. The court said: "The adequacy of the security of the mortgage to pay all the bonds being doubtful, it is the interest of every bondholder to diminish the debt of every other bondholder. In so far as he succeeds in doing that he adds to his own security. Each holder should be present to defend his own claim, and that he may attack the other claim should there be just occasion for it. If, upon a fair adjustment of the amount of the claims, there should be a deficiency in the security, real or apprehended, every one interested should have notice in advance of the time, place, and mode of sale, that he may make timely arrangements to secure a sale of the property at its full value."

[2] Sahlgaard *v.* Kennedy (1882), 13 Fed. Rep. 242, 244; Kropholler *v.* St. Paul, Minneapolis, & Manitoba Ry. Co. (1880), 3 Fed. Rep. 302, on demurrer. Compare Messchaert *v.* Kennedy (1882), 4 McCrary, 133.

[3] Willmer *v.* Atlanta & Richmond Air Line R. Co. (1875), 2 Woods, 447, 451; Hackensack Water Co. *v.* De Kay (1883), 36 N. J. Eq. 548, citing Daniell's Ch. Pr. 217.

[4] *In re* Chickering (1883), 56 Vt. 82.

zens of the State with which the district is wholly or partially coterminous.[1]

Bondholders and not coupon-holders, declining to come in as parties plaintiff, may be joined as defendants.[2]

§ 483. **Representative Position of Trustee in Suits affecting the Trust Property generally.** — From the fact that the trustee and the *cestuis que trust* are the owners of the whole interest in the trust estate, it follows from the fundamental rule of equity in regard to parties that, in suits relating to the estate brought by or against strangers, both the trustee and the *cestuis que trust* are, under ordinary circumstances, necessary parties.[3]

Upon this rule, however, there have been engrafted several exceptions.[4]

One of these, in the case of railroad mortgages, may almost be said to overshadow the rule itself. The doctrine now universally accepted is that the trustee is, in the absence of some special consideration, the only necessary party in suits to enforce or defend the rights of bondholders. This doctrine may be referred to two principles: (1) The bondholders usually constitute a numerous class having a common interest, and therefore suits by or against them fall into the category of those in which appearance by a representative is permissible. (2) The nature of the contract is such that the bondholders, in purchasing their securities, may reasonably be assumed to have agreed that the trustee should, under ordinary circumstances, be that representative.

In some of the cases the inconvenience and unnecessary expense which would be caused by an adherence to the general rule as to joining all parties in interest is emphasized in some of the cases which sustain this doctrine.[5] In others stress is

[1] Jackson & Sharp Mfg. Co. *v.* Burlington & L. R. Co. (1887), 29 Fed. Rep. 474.

[2] Hotel Company *v.* Wade (1877), 97 U. S. 13.

[3] Perry on Trusts, § 873; Daniell's Ch. Pr., pp. 220 ff. and 256 ff.

[4] See Perry on Trusts, § 873; Wood's Ry. Law, 1630.

[5] Willink *v.* Morris Canal & Bkg. Co. (1843), 4 N. J. Eq. 377; Murdock *v.* Woodson (1873), 2 Dill. 188; Shaw *v.* Norfolk County R. Co. (1855), 5 Gray (Mass.), 162.

In the first case the court based its opinion expressly on the ground that the parties were numerous, and its language shows that this principle was deemed to be properly applied, whether the trustee be a nominal or an active one. In this respect the case is in conflict with Bardstown & Louisville R. Co. *v.* Metcalf (1862), 4 Metc. (Ky.) 199, where it was held that a statutory provision declaring that, "where the question is one of common or general interest of many persons, or where the parties are numerous, and it is impracticable to bring them all before the court within a reasonable time, one or more may sue for the benefit of all," does not apply to a naked trustee. It was considered, however, that as the mortgage in question conferred upon the trustee the power "to proceed by due course of law"

laid rather upon the nature of the contract, and the understanding of the parties as gathered from its terms, that the bondholders will be bound by what is done by the trustee.[1]

The rule as to the representative functions of a trustee applies to an *ex officio* trustee, such as a State treasurer, to whom the conveyance is made by virtue of a statute.[2]

The title and interest of trustees are sufficiently alleged where they are described in the bill as "trustees for divers parties" and others, as "certain holders of said coupon bonds and *cestuis que trust*" of the trustees, and the stating part of the bill alleges the execution of the mortgage by which they were constituted trustees.[3]

to sell the railroad property upon default in the payment of the interest or principal of the bonds, he was more than a naked trustee, and that this fact took the case out of the ordinary rule of equity practice which requires a trustee, under a mortgage to secure payment of money to others, to join his *cestuis que trust* in a suit for foreclosure and sale.

1 "Under some circumstances," said Chief Justice Waite in Kerrison *v.* Stewart (1876), 93 U. S. 155, 160, "a trustee may represent his beneficiaries in all things relating to their common interest in the trust property. He may be invested with such powers and subject to such obligations, that those for whom he holds . . . will be bound by him. The difficulty lies in ascertaining whether he occupies such a position, not in determining the effect if he does. If he has been made such a representative, it is well settled that his beneficiaries are not necessary parties to a suit by him against a stranger to enforce the trust, or to one by a stranger against him to defeat it in whole or in part." In Farmers' Loan & Trust Co. *v.* Central Railroad of Iowa (1877), 4 Dill. 533; s. c. 8 Fed. Cas. 1037, Case No. 4663, Judge Dillon used very similar language: "Under a railway mortgage, where it is contemplated that bonds to a large number will be executed and negotiated, and where the holders of these bonds may be scattered over the whole face of the earth, it becomes very important to appoint a trustee, and the trust deed for that purpose usually prescribes the powers and duties of the trustee. Now all the purchasers of the bonds must take under the rights which that instrument gives them, and the effect of this is that the trustee, while acting in the line of his duty, and within the scope of his powers, is a representative of all the bondholders." So also in Campbell *v.* Railroad Co. (1871), 1 Woods, 368, Justice Bradley considered that the very fact that trustees are interposed to receive and hold the mortgage given to secure an issue of bonds amounting to hundreds and thousands, and transferable by delivery, shows that it is the intent and understanding of all parties, unless the contrary appears, that the trustees are to represent the bondholders in all matters of litigation respecting their common and general rights.

This view of the matter had been anticipated by the Irish Court of Chancery many years previous in dealing with an objection on the non-joinder of the *cestuis que trust*, under a trust deed to raise arrears of an annuity, Hart, L. C., laying down the general rule that "when it appears on the face of the contract that it was the intention of the parties to exclude the *cestuis que trust* from the necessity of taking any part in the transactions relating to the management of trust, a court of equity will dispense with their being made parties to the suit. Bifield *v.* Taylor, 1 Beaty, 92; s. c. 1 Moll. 192, cited in Kerrison *v.* Stewart, *supra*.

2 Boston & New York Air Line R. Co. *v.* Coffin (1882), 50 Conn. 150; s. c. 12 Am. & Eng. R. R. Cas. 375.

3 Savannah & Memphis R. Co. *v.* Lancaster (1878), 62 Ala. 555.

As to whether it is necessary that the trustee who brings suit without joining his *cestui que trust* should state upon the face of his bill that they are numerous and cannot, without great inconvenience, be brought before the court, the authorities are at variance. In New Jersey it has been held that no such averment is necessary, as the mortgage itself, when set out in the bill, sufficiently discloses the character of the transaction.[1]

In Kentucky it has been held that even where the trustee has the power to "proceed by due course of law" to have the railroad property sold, he cannot sue without joining his *cestuis que trust*, unless he alleges and shows that they are numerous, and that it is impracticable to bring them before the court within a reasonable time.[2]

When thus suing as the representative of the bondholders, for a breach of the contract of the mortgage, a trustee must be treated as a real party plaintiff for purposes of jurisdiction as between the Federal and State courts.[3]

A foreclosure suit may be maintained by one of three trustees, where one of the others is dead, and the third is interested in the property and assets of another company which has purchased the property mortgaged.[4] (Compare § 490, *post.*)

It is at least doubtful whether a trustee who has commenced a suit on the theory that he has received, in accordance with a provision of the mortgage, a request from the holders of a certain proportion of the bonds, can, upon its being shown that a sufficient number of bondholders have not joined in the request, maintain the suit by virtue of a discretionary power which he has under the mortgage to take action whenever he deems it to be for the interest of the bondholders and all concerned.[5]

§ 484. **Request to begin Suit must come from Owners, not merely Holders of Bonds.** — Proceedings to enforce a mortgage cannot be instituted by virtue of a provision authorizing the trustee to apply to a court for foreclosure and sale upon receiving a request to that effect from the holders of a certain amount of the bonds, unless the parties so requesting are not only holders but owners of the bonds. A request from an agent who holds the bonds subject to the order of the real owners will not authorize the trustee to take action.[6]

[1] Willink *v.* Morris Canal & Bkg. Co. (1843), 4 N. J. Eq. 377.

[2] Bardstown & Louisville R. Co. (1862), 4 Metc. (Ky.) 199.

[3] Knapp *v.* Railroad Company (1873), 20 Wall. 117; Coal Company *v.* Blatchford (1870), 11 Wall. 172.

[4] Robinson *v.* Alabama & Georgia Mfg. Co. (1891), 48 Fed. Rep. 12.

[5] Farmers' Loan & Trust Co. *v.* New York & Northern R. Co. (N. Y., 1896), 44 N. E. Rep. 1043.

[6] Ibid.

§ 485. **Suits in which the Trustee is the Proper Party Plaintiff.** — From the above principles it follows that, under ordinary circumstances, the trustees are the proper parties to institute a suit for the foreclosure of the mortgage;[1] or to maintain and defend the trust fund against wrongful attack or injury tending to impair its safety or amount;[2] or to apply for an injunction to restrain an alleged illegal proceeding which will injure the value of the bonds and cast a cloud upon the security; or to bring suit to have a controverted priority or lien settled before an irredeemable sale is made under another mortgage which is claimed to rank above the one made to the petitioners;[3] or to secure from the company an accounting where it has neglected to apply the earnings to the mortgage debt.[4]

§ 486. **Bill filed by or against Trustees alone not demurrable for Defect of Parties.** — Where the trustees unite in bringing a fore-

[1] Willink *v.* Morris Canal & Bkg. Co. (1843), 4 N. J. Eq. 377; Shaw *v.* Norfolk County R. Co. (1855), 5 Gray (Mass.), 162; Bardstown & Louisville R. Co. *v.* Metcalfe (1862), 4 Metc. (Ky.) 199; Campbell *v.* Railroad Co. (1871), 1 Woods, 368; Credit Co. *v.* Arkansas Central R. Co. (1882), 15 Fed. Rep. 46, 52; McHenry's Petition (1878), 9 Abb. N. C. 256; Hale *v.* Nashua & Lowell R. Co. (1880), 60 N. H. 333; Barnes *v.* Chicago, Milw. & St. Paul Ry. Co. (1887), 122 U. S. 1; Savannah & Memphis R. Co. *v.* Lancaster (1878), 62 Ala. 555.

[2] Western Railroad Co. *v.* Nolan (1872), 48 N. Y. 513; Union Trust Co. *v.* Illinois Midland Ry. Co. (1886), 117 U. S. 434, 455.

[3] Murdock *v.* Woodson (1873), 2 Dill. 188.

[4] Morgan *v.* Kansas Pacific R. Co. (1882), 15 Fed. Rep. 55; Barry *v.* Missouri, K. & T. Ry. Co. (1884), 22 Fed. Rep. 631; Mercantile Trust Co. *v.* Portland & Ogdensburg R. Co. (1882), 10 Fed. Rep. 604.

This principle has, however, been held not to be applicable where it is stipulated that the bonds are to bear such interest as the directors fix in accordance with the provisions of a trust mortgage pledging the net earnings to the payment of the principal and interest, and the right of action is based on the allegations that the directors have fraudulently conspired to compel the bondholders to surrender their bonds, have fraudulently withheld net earnings payable thereon, and have made false, fraudulent, and fictitious ascertainments of the income. An action may, it is said, be maintained by a bondholder, under such circumstances, for ascertainment and payment of the amount due, and the trustee is not a necessary party. The reason assigned was that such a proceeding is merely an attempt to compel the defendant to fulfil its agreement fairly and honestly without resorting to the security provided by the deed of trust. There being no foreclosure of the mortgage asked for, but simply an endeavor to collect a debt due to the bondholder, the trustee could not bring the suit, and had no interest in it. The first two cases cited in the present note were distinguished on the ground that the remedy sought in them could be obtained only through the trustee. Spies *v.* Chicago & E. I. R. Co. (1887), 30 Fed. Rep. 397, 398. The distinction here drawn seems to be of very dubious soundness. The earnings pledged by the mortgage in question can only be regarded as a portion of the trust property, and it is difficult to see how the application of such earnings to the interest on the bonds can be enforced except through the person whose title as grantee under the mortgage is the sole foundation of the bondholder's claim. The imputation of fraud, it is submitted, is not a sufficient ground for breaking in upon the general rule.

closure suit; the mortgagor cannot demur to the bill on the ground that, because the bondholders are not joined, there is a defect of parties. Shaw *v.* Norfolk County R. Co.[1] is perhaps the leading American case on this point. There Judge Bigelow, after referring to the general rule which requires all parties to be joined who are materially interested in the subject-matter of the suit, and reviewing some of the cases illustrating the exception made to that rule, where there are numerous parties having a common interest, proceeded as follows: "The case at bar clearly comes within the principles on which these decisions rest. The bondholders for whose benefit the mortgage set out in the bill was made are very numerous, and the bonds being assignable, it would be very difficult, if not wholly impracticable, to ascertain with accuracy at any given time who were the owners of them, so as to make them all parties to a suit in equity. Nor is it necessary that any of them should be joined to represent their own rights and interests and those of the other *cestuis que trust* under the indenture. The main purpose of the instrument was to vest the property in the trustees, with full power and authority to act as the representatives of the *cestuis que trust* in all things relating to their common rights and interests. The sole object of the bill is to secure and protect these rights and interests. The trustees have no adverse claims against their *cestuis que trust.* On the contrary, they only seek, as the representatives of the bondholders, to enforce the trusts created for their benefit, and in which they all have a common interest. It is sufficient, therefore, that the court have before them those who are the full representatives of the parties beneficially interested in the property, so that those interested will be bound by the decree." For the purposes of this rule it makes no difference that some of the bondholders hold bonds of the corporation issued before the date of the mortgage. So far as they claim any benefit or interest under the indenture, they are as fully represented by the trustees as those whose bonds were acquired after the execution of the mortgage.[2]

[1] 5 Gray, 162 (1855).

[2] Shaw *v.* Norfolk County R. Co. (1855), 5 Gray (Mass.), 162. This case was followed in Cheever *v.* Rutland & Burlington R. Co. (Vt., 1869), 4 Ann. Ry. Rep. 291, where the trustees under a first mortgage filed a suit for foreclosure of their lien, making the trustees under a second mortgage, and some of the bondholders, defendants. The court said that it was not necessary to join any of the bondholders, even those who had actually been joined in a former suit to which the present one was in a manner supplementary, but that they were admissible as parties, and their joinder served the purpose of assuring the court that there was such publicity to the suit as would shut the door to collusion, and secure as full a defence as the facts would warrant. The cases in which bondholders apply to be admitted as parties raise questions as to

Proceedings under cross-bills to which the trustees are made parties defendant will not be invalid for the reason that some bondholders who may have intervened after the cross-bills were filed have not been made parties thereto.[1]

§ 487. **Defences available against the Bondholders are available against the Trustee.** — Since bondholders are the real parties in interest, every defence available against them is available in a suit brought by the trustee in their behalf. Thus, where a company, holding the bonds of another company, goes into possession of the property of the latter under a lease, agreeing to apply the net income to the payment of the interest on the bonds, the mortgagor has a valid defence to a trustee's suit to foreclose the mortgage for default in the payment of the interest coupons, if he can show that the net income has been sufficient to discharge the sum due upon such coupons.[2]

§ 488. **Trustee as Party Defendant generally.** — The principles illustrated in the preceding sections are equally applicable where the interests of the bondholders as a class are attacked. In such a case the trustees are necessary parties defendant. Thus the trustees of mortgages on a road which the majority of the stockholders sell by means of an amicable foreclosure suit, in which all the trustees and the corporation are parties, must be joined as defendants in a subsequent suit against the purchasers, in which the dissenting stockholders seek to set aside the sale.[3]

So also the trustees under a second mortgage are necessary parties defendant to a bill filed by the holder of bonds secured by a first mortgage on a part of the road and a second mortgage on the rest of it, for the purpose of having an accounting of the earnings of the different portions of the road.[4]

the fitness of the trustee to act as their representative, not as to the sufficiency of the parties, and will be considered below. To the same effect see Lambertville Nat. Bank *v.* McCready Bag & Paper Co. (N. J. Eq., 1888), 15 Atl. Rep. 388.

[1] Muller *v.* Dows (1877), 94 U. S. 444.

[2] Chamberlain *v.* Connecticut Central R. Co. (1887), 54 Conn. 472; s. c. 9 Atl. Rep. 244.

[3] Ribon *v.* Railroad Co. (1872), 16 Wall. 446. There the Supreme Court, in sustaining the dismissal of the bill for defect of parties, said: "If the sale should be annulled, they might be in the situation of the plaintiff who collects a judgment which is afterwards reviewed. He may be called upon to refund, and compelled to do so. A question would also arise whether the consideration of the agreement under which the fixed amount of bonds was paid had not failed, and whether all the bondholders and shareholders who participated in the distribution of the proceeds of the sale should not be required to refund. If either or both were too numerous for all to be brought before the court, some might have been made parties in their own behalf, and as the representatives of the others." To the same effect see Harwood *v.* Railroad Co. (1872), 17 Wall. 78.

[4] Mercantile Trust Co. *v.* Portland & Ogdensburg R. Co. (1882), 10 Fed. Rep.

But it is not necessary that a trustee who has been substituted by the voluntary act of the parties, and without the sanction of the court, during the pendency of a suit to enforce the trust should be brought in as a party.[1]

The same rule holds good where the substitution is made by the consent of the court.[2]

§ 489. **Joinder of Non-resident Trustee as Defendant.** — The fact that a railroad trustee is non-resident does not obviate the necessity of joining him as a defendant to a foreclosure suit in a court of any jurisdiction where a statute is in force which, like the federal statute of 1875, provides that indispensable parties may be brought into court by publication, if the suit be one to enforce any legal or equitable lien upon, or claim to, or remove an incumbrance or lien or cloud upon the title to real or personal property within the district where such suit is brought. See ch. 137, § 8, U. S. Rev. Stat.[3]

But where there are five trustees, and four of them have been served with process, the presence of the fifth, if a non-resident, may be dispensed with. The *cestuis que trust* are fully represented in such a case by the majority of the trustees. In fact, if but a single one of the trustees is in court, the *cestuis que trust* are sufficiently protected against any possible harm from an adverse decree.[4]

§ 490. **Trustee's Control of Suits affecting the Trust Property.**— The principle that the trustee is the proper party to protect the

604. In Willink *v.* Morris Canal & Bkg. Co. (1843), 4 N. J. Eq. 377, an objection that the trustee of a second mortgage was not made a party defendant was overruled on the ground that the property subject to the mortgage was small, and the *cestuis que trust* were themselves before the court.

[1] Morton *v.* New Orleans & Selma R. Co. (1885), 79 Ala. 590. The court considered that the Alabama statute authorizing amendments at any time before final decree, by "striking out or adding new parties," was not to be construed as authorizing, in every case, as a matter of right, the introduction by amendment of new parties who by purchase or assignment *pendente lite* have acquired an interest in the subject-matter of the suit. The rule that a purchaser of property *pendente lite* takes it subject to the hazards of the pending suit was considered to be particularly applicable to a trustee substituted *pendente lite*.

[2] Mobile & Cedar Point R. Co. *v.* Talman (1849), 15 Ala. 472.

[3] Mercantile Trust Co. *v.* Portland & Ogdensburgh R. Co. (1882), 10 Fed. Rep. 604; Massachusetts Mut. Life Ins. Co. *v.* Chicago & A. R. Co. (1882), 13 Fed. Rep. 857.

[4] Stewart *v.* Chesapeake & Ohio Canal Co. (1880), 1 Fed. Rep. 361. The court said: "The absent trustee has no interest. He is a mere trustee for the purpose of doing a duty upon a certain contingency. He holds a public trust. He has no title to anything. He has no legal estate in any property. His claim for compensation, even in the event of his being called upon to exercise the trust reposed in him, is a matter not fixed by law, but is altogether within the discretion of a court of equity."

interest of the bondholders as a body is deemed to involve the conclusion that, under ordinary circumstances, individual bondholders will not be permitted to take part in litigation by or against their trustee in regard to the trust property.[1]

In this respect, it will be observed, there is an important difference between the position of a trustee representing the whole body of bondholders and of a representative bondholder acting for his co-bondholders. In the latter case the bondholders not named in the bill may come in as a matter of right, since the suit is instituted expressly for the benefit of such as do come in. (See § 482, *ante.*)

The incapacity of the bondholders to act independently will, of course, be more strongly inferred, if special powers are conferred on the trustee in regard to litigation for the enforcement of the security. Thus where the trustees, and not the bondholders, have the option of declaring the principal due upon default in the interest, a bondholder who dissents from a funding scheme sanctioned by the majority on the ground that it contemplates a diversion of the trust funds, cannot come into a court of equity and ask for a foreclosure, without a demand being made on the trustees in any form, but is entitled to be made a party to a suit already commenced by the trustees for possession. When this is done, it will be for the court to consider what his equities are, and how far they have been impaired, if at all, by the acts of the trustees.[2]

To entitle bondholders to intervene in a trustee's suit for the purpose of taking an active part in the proceedings, it must be shown that the trustee has exceeded his authority, or is for some reason an unfit person to have charge of their interests. Thus holders of a majority in amount of the bonds, who contend that under a proper construction of the mortgage there can be no foreclosure without permission of a majority, should be permitted to come in as defendants in a foreclosure suit instituted by the trustees at the instance of the minority of the bondholders.[3]

So a case in which intervention is permissible and proper arises when it appears that the trustee is also trustee under another mortgage on the same property, for which priority is claimed, as against the one on which the suit is being brought;[4] or that his interests have ceased in some other way to be identical

[1] Sage *v.* Central Railroad Co. of Iowa (1876), 93 U. S. 412.

[2] Stern *v.* Wisconsin Central R. Co. (1879), 1 Fed. Rep. 555; s. c. 8 Rep. 488.

[3] Toler *v.* East Tennessee, Va. & Ga. Ry. Co. (1894), 67 Fed. Rep. 168.

[4] Mercantile Trust Co. *v.* Lamoille Valley R. Co. (1879), 16 Blatch. 324.

with those of the bondholders,[1] as, for example, that the proper amount of his allowance has become a contested question in the suit;[2] or that the trustee has done, or contemplates doing, in the proceedings some act which will be detrimental to the interest of such bondholder or set of bondholders;[3] or that he is not responsible, or is likely to prove unfaithful to his trust;[4] or is negligent and incompetent in the discharge of his duties.[5]

[1] Skiddy *v.* Atlantic, Miss. & Ohio R. Co. (1878), 3 Hughes, 320, 329; s. c. 22 Fed. Cas. 274, Case No. 12,922, which holds that the fact of the bondholders being divided as to the proper course to take, and the trustees acting in accordance with the wishes of one of these factions, does not make the interest of the trustees adverse to those of the other faction in such a sense as to entitle the latter faction to intervene personally in the suit. The court said in answer to the point thus raised: "There is but one class of bondholders under this mortgage. The interests of each bondholder are identical. Some of the bondholders have moved the actions of the trustees, and others have not. The one are active bondholders and the other are inactive. Some of them are represented by one committee and others are represented by another; but this does not constitute a class of bondholders. Their interests are identical, and one might as well say that, because bondholders under the same mortgage were represented in court by different counsel, that constituted them a different class of bondholders, and that they were, because represented by different persons, entitled to be parties to this suit."

In Phinizy *v.* Augusta & K. R. Co. (1894), 55 Fed. Rep. 445, it was argued, as a ground for allowing the intervention of a committee of bondholders of a number of bonds issued by several of the companies composing a large system, that the interests represented by the trustee were conflicting; but the court replied that, if those interests were so conflicting as to render it improper for the trustees to act, it must follow that the petitioners themselves, for the same reason, would also be incapacitated to act.

[2] Williams *v.* Morgan (1884), 111 U. S. 684, 696.

[3] Skiddy *v.* Atlantic, Miss. & Ohio R. Co. (1879), 3 Hughes, 320, 351. There the court, in refusing an application of bondholders to be allowed to intervene, said: "The moment a petition is presented to this court by any party interested in the conduct or result of the suit, which alleges that these trustees are derelict, incompetent, or partial in any action they propose to the court, that petition shall be, as it is entitled to be, respectfully heard; and if, after consideration of the proof, it shall be ascertained that the petitioner is correct, the trustees will be removed, and the bondholders allowed to conduct the suit in their own way, without the intervention of trustees except so far as they may be nominal parties to it."

The provision thus made for the interests of the dissatisfied bondholders was deemed to answer all the purposes of the petition whereby they were seeking to become parties to suit, except that the bondholders represented, or alleged to be represented, by the signers of that petition might not have the right of appeal from any decree of the court which they thought unfavorable to their specific and personal interests, unless made parties to the record. In regard to this possible objection it was observed: "Under those circumstances, when they arise, we think any bondholder who feels that his rights are injured by the action of the trustees or of the court has the right to be put in such position either as plaintiff or defendant as will enable him to have them adjudicated by an appellate court." It was considered also by Judge Hughes that the bondholders who did not unite in directing the trustees to move for foreclosure might of mere right be made parties defendant to the suit.

[4] Coe *v.* Columbus, Piqua, & Indianapolis R. Co. (1859), 10 Ohio St. 372; Winslow *v.* Minnesota & Pacific R. Co. (1860), 4 Minn. 313.

[5] Richards *v.* Chesapeake & Ohio R. Co. (1875), 1 Hughes, 28.

A minority of the bondholders who object that they have been unjustly discriminated against by the trustee in regard to a reorganization scheme, and that he has awarded the receiver improper compensation and extravagant amounts for expenditure, should be allowed to become parties so far as to permit an examination of these charges.[1]

So also, as the minority bondholders may institute proceedings for the removal of a trustee for breach of trust, the trustee cannot bring an action in the same court, and on the theory that such bondholders are improperly resisting a scheme of reorganization to which a large majority of the bondholders have assented, and which is for the best interest of all, obtain an injunction perpetually staying the action for such removal. That the trustee in seeking the injunction offers to perform such parts of his trust as he is charged with having omitted or neglected cannot affect the application of this rule, for the very question involved in the first action is whether he shall be allowed to act at all as trustee, — whether, in other words, he has not forfeited all authority to act in his representative character.[2]

§ 491. **The Proper Way for a Bondholder to raise the Question of the Trustee's Unfitness to conduct the Suit** is to apply to be admitted as a party thereto for the purpose of having that question determined. A bill filed by him in an independent suit, in which he complains that the trustee has in various ways violated his trust, and asks for a foreclosure of the mortgage, will be dismissed, inasmuch as it would be an anomaly to have pending at the same time in the same court two suits in which the relief asked for in regard to the property rights of the bondholders is identical.[3]

This rule, however, is applicable only to cases in which the bondholder files his suit in a court of the same sovereignty. The pendency of proceedings for foreclosure in a State court, at the instance of the trustee, is no bar to another suit in a federal court by one of the bondholders asking both for the foreclosure of the mortgage and the removal of the trustee.[4]

[1] DeBetz's Petition (1878), 9 Abb. N. C. (N. Y.) 246.

[2] Farmers' Loan & Trust Co. *v.* McHenry (1878), 9 Abb. N. C. 235.

[3] Stern *v.* Wisconsin Central R. Co. (1879), 1 Fed. Rep. 555.

[4] Mercantile Trust Co. *v.* Lamoille Valley R. Co. (1879), 16 Blatch. 324. In that case the court based its ruling, partially at least, upon the ground that the bondholders, although *quasi parties* to a suit in which the trustees are the actual plaintiffs, are not represented by him to such an extent that, when he brings suit, they become parties thereto, whether they will or not; according to the doctrine of Stanton *v.* Emery, 93 U. S. 548, which lays down the general rule that the pendency of a suit *in personam* in a State court is no bar to a similar suit between the same parties.

Whether the *cestui que trust* shall be allowed to intervene in a suit in which he is already represented by the trustee is a matter which lies in the discretion of the trial judge; and the appellate court will not interfere with the exercise of that discretion unless it is abused.[1]

The same principle holds where the pending trustee's suit is in a sister State.[2]

§ 492. **Proper Time to intervene.**[3] — The general rule is that the bondholders, being *quasi* parties in a trustee's suit, may, if adequate cause is shown, intervene and make themselves actual parties as long as the proceedings are *in fieri*, and not definitely closed by the course and practice of the court.[4] But at the same time it is necessary that bondholders who are discontented with the conduct of the trustees must act with due diligence in asserting their alleged rights, and take upon themselves the responsibility for the consequences of the litigation. After a period of sixteen months has elapsed, during which the trustee has been recognized as the representative of the bondholders, and the court is about to close the case finally, a bondholder will not be allowed to appear for the railroad company to open and prolong the litigation, to the apparent injury of all concerned, without an offer on his part to assume the responsibility for what might result from his interference.[5]

§ 493. **Bondholder allowed to intervene only to enforce Rights accruing under the Mortgage.** — A bondholder can intervene in a foreclosure suit brought by a trustee only to procure the enforcement of rights which he possesses by virtue of the provisions of the mortgage itself. Hence the personal claim of a bondholder

[1] Winslow *v.* Minnesota & Pacific R. Co. (1860), 4 Minn. 313. In a federal court, even for the same relief, it seems to be scarcely necessary to rely upon the special reason here put forward. See also the following note.

[2] Hollister *v.* Stewart (1889), 111 N. Y. 644; s. c. 19 N. E. Rep. 782; 38 Am. & Eng. R. R. Cas. 599. In this case there was said to be a still stronger objection to the position that the pendency of the other suit debarred the bondholder from seeking relief; viz., that he was not a party to the proceedings in the court of the sister State, and had a full right to pursue his remedy in his chosen tribunal. The application of the plaintiff being based upon the allegation that the trustee had misapplied the trust funds, the case came under the principle that a bondholder has a right to take independent action whenever his interests become antagonistic to those of the trustee. The court remarked that it would be little less than repulsive to one's sense of justice to hold that the trustee represented the complaining bondholder in a suit the object of which was virtually to have his violation of the trust condoned.

[3] See above as to the time during which intervention in a suit brought by a bondholder is allowed.

[4] Campbell *v.* Railroad Co. (1871), 1 Woods, 368.

[5] Central Trust Co. *v.* Texas & St. Louis R. Co. (1885), 24 Fed. Rep. 153.

arising out of an outstanding equity against the company, cannot be adjusted in the foreclosure suit, nor his demand attached to the foot of the mortgage, for the purpose of enabling him to reach the unappropriated balance of the lien.[1]

§ 494. **Intervention by Trustee in Bondholder's Suit.** — The trustee's right to control the proceedings is not lost merely because he has refused at first to bring suit. He may answer a bondholder's bill in which such refusal is alleged, and ask to be made complainant; and unless there is some additional reason why he

[1] Vose *v.* Bronson (1867), 6 Wall. 452. There bonds were issued to a material-man in payment for railroad iron, the transaction being consummated on the assumption that they were worth eighty per cent of their face value. To guard against loss by depreciation of the securities it was agreed that, if the company should sell any of their bonds to any one during a certain time named, at a less rate than eighty per cent of the face value, the material-man should receive so many additional bonds as would pay for the iron in full, estimating the bonds already given, and those to be given, at the lowest rate at which any bonds had been sold. The price of the bonds fell to forty per cent of their face value, and, as the decree had determined the actual amount due on the whole issue to be considerably less than the amount secured by the mortgage, the assignee of the claim of the material-man applied to be allowed to have the benefit of this unappropriated lien. In approving of the refusal of the lower court to grant this application, the Supreme Court said : "To do this there must be a power somewhere to enlarge the mortgage, and where is it lodged? Certainly not with the trustees, for their duty is to see that the security held by them for their *cestui que trusts* is enforced according to the terms of the deed. They could neither enlarge the mortgage nor consent to its enlargement. The court could not do it, nor the La Crosse Company, as it had covenanted with the trustees in behalf of the bondholders that it would only issue four millions of dollars in bonds. The rights of the bondholders were fixed by the terms of the mortgage. The value of the bonds as an investment depended in a great measure on the number to be issued, and doubtless each purchaser, before he bought, had information of the character of the security on which he relied. The property might be very well a safe security for four millions of dollars, and very unsafe for any additional amount. The doctrine contended for would utterly destroy the marketable value of all corporate securities. No prudent man would ever buy a bond in the market if the provisions made for its ultimate redemption could be altered without his consent. But it is said, as the court rendered a decree for less than the face of the bonds, equity will step in and allow the appellant to apply the vacuum of principal secured by the mortgage to liquidate his claim. The answer to this is, that it does not concern the appellant whether the court rightfully or otherwise reduced a portion of the bonds. The bondholders, whose bonds were thus reduced, are the only parties in interest who could have any just cause of complaint against the action of the court; and if they did not feel aggrieved, no other person has any right to complain. The security of the mortgage extended to four millions of bonds only, and whatever amount the court should ascertain was due on those four millions was the amount secured and no more.

"If Vose had been made a party defendant to the foreclosure suit, the decree would have been the same. But he was not a necessary party to that suit. The trustees, as the representatives of all the bondholders, acted for him as well as the others. It would be impracticable to make the bondholders parties in a suit to foreclose a railroad mortgage, and there is no rule in equity which requires it to be done."

should not be permitted to exercise his representative functions, the cause will be prosecuted thereafter in his name.[1]

The result of their being thus permitted to avail themselves of the suit already begun is that in legal effect the suit becomes their suit,[2] and thenceforth they become charged with its conduct.[3]

§ 495. **Action of Trustees, to what Extent binding on Bondholders generally.** — The general rule is well settled that, in the absence of fraud, the beneficiaries in railway mortgages are bound by whatever is done by their trustees in suits instituted by the latter for the protection of the interests of such beneficiaries.[4]

An order or decree in proceedings to which a trustee is made a party as defendant is equally conclusive, — a principle most frequently applied where it is sought to cut off the lien of bondholders secured by a junior mortgage.[5]

[1] Alexander *v.* Central Railroad of Iowa (1874), 3 Dill. 487; s. c. 1 Fed. Cas. 363, Cas. No. 166; Chesapeake & Ohio R. Co. (1877), 1 Hughes, 28.

[2] Pacific Railroad *v.* Ketchum (1879), 101 U. S. 289, 299.

[3] Richards *v.* Chesapeake & Ohio R. Co. (1876), 1 Hughes, 28. In this case the trustees had commenced proceedings in a State court, and were admitted as parties in a suit afterwards begun by the bondholders in a federal court. Having thus obtained control of the suit, the trustees asked that the bill be dismissed in the latter court, so that the first one might proceed, the ground assigned for the request being that it was for the advantage of all the parties in interest that prior as well as subsequent incumbrancers should be made parties to the proceedings, in order to realize the full value of the premises; and that this could not be done in the federal court for the reason that a trustee under a prior, and a trustee under a subsequent, mortgage were citizens of the same State as the petitioners. The court acceded to this request, and refused to permit the bondholders who objected to the dismissal of the bill to file a new bill, making the proper parties, and relating back to the time of filing the one dismissed. It was declared that, as the trustees had undertaken to foreclose the mortgage, no bondholder had a right to proceed in his own name for the same purpose.

[4] Young *v.* Montgomery, etc. R. Co. (1875), 2 Woods, 606; Credit Co. *v.* Arkansas Cent. R. Co. (1882), 15 Fed. Rep. 46; Richter *v.* Jerome (1887), 123 U. S. 233; Kerrison *v.* Stewart, 93 U. S. 155; Shaw *v.* Railroad Co. (1879), 100 U. S. 605; Corcoran *v.* Chesapeake & Ohio Canal Co. (1876), 94 U. S. 741; First National Bank of Cleveland *v.* Shedd (1887), 121 U. S. 74; Beals *v.* Ill., Miss. & Tex. R. Co. (1890), 133 U. S. 290; Campbell *v.* Railroad Co. (1871), 1 Woods, 368; Farmers' Loan & Trust Co. *v.* Kansas City, W. & N. W. R. Co. (1892), 53 Fed. Rep. 182; Pollitz *v.* Farmers' Loan & Trust Co. (1892), 53 Fed. Rep. 210; Huntington *v.* Little Rock & Fort Smith Ry. Co. (1882), 16 Fed. Rep. 906; Farmers' Loan & Trust Co. *v.* Central Railroad of Mont. (1877), 4 Dill. 533; Kent *v.* Lake Superior Ship Canal, Iron, & Coal Co. (1892), 144 U. S. 75.

[5] McElrath *v.* Pittsburgh & Steubenville R. Co. (1871), 68 Pa. St. 37, s. c. 1 Am. Ry. Rep. 139; First National Fire Ins. Co. *v.* Salisbury (1881), 130 Mass. 303; s. c. 4 Am. & Eng. R. R. Cas. 480; Board of Supervisors *v.* Mineral Point R. Co. (1869), 24 Wis. 93; Wallace *v.* Loomis (1877), 97 U. S. 146; Union Trust Co. *v.* Illinois Midland Ry. Co. (1886), 117 U. S. 434; Cheever *v.* Rutland & Burlington R. Co. (1869), 4 Am. Ry. Rep. 291; Campbell *v.* Railroad Co. (1871), 1 Woods, 368; Union Trust Co. *v.* Illinois Midland Ry. Co. (1886), 117 U. S. 434, 455; Beals *v.* Ill., Miss. & Tex. R. Co. (1886), 27 Fed. Rep. 721.

As regards the rights of the bondholder so secured, the conclusiveness of a decree is not impaired by the fact that the trustee happens to be also the trustee of the first mortgage, and was made defendant in that capacity in a suit brought by coupon-holders for the foreclosure of the mortgage.[1]

Even if the trustee has been guilty of fraud, a decree annulling the bonds cannot be set aside after the railroad property has passed by virtue of the judicial sale into the hands of a purchaser without notice of the fraud.[2]

The decree of a federal court in one district in a suit in which the trustees represent the bondholders will be a bar to an action by one of a minority to whom the trustee's course was not acceptable, instituted in another district for the purpose of having his bonds collected according to the terms of the mortgage, provided the interests of the minority have been duly protected by the first court, and no fraud on the part of the trustee is shown.[3]

[1] Corcoran *v.* Chesapeake & Ohio Canal Co. (1876), 94 U. S. 741; affirming s. c. Macarthur, 358 (1874). In this case the bondholders, after the rendition of a decree in the State court in the suit of the coupon-holders, instituted proceedings in the federal court, contending that, as between the mortgagor, the State, and the trustees, who had all been made defendants, no issue was raised by the pleadings, and no adversary proceedings were had. In answer to this argument the court said: "In chancery suits, where parties are often made defendants because they will not join as plaintiffs, who are yet necessary parties, it has long been settled that adverse interests, as between co-defendants, may be passed upon and decided; and if the parties have had a hearing and an opportunity of asserting their rights, they are concluded by the decree, as far as it affects rights presented to the court and passed upon by its decree." "The very object of that suit in the State court was to determine the order of distribution of the revenues of the mortgagor canal company, and these trustees were made defendants for no other purpose than that they might be bound by that decree." The complainant also contended that he was only a party in his representative capacity of trustee, and, as he was now suing in his individual capacity, was not bound by the decree. The court disposed of this theory as follows: "But why is he not bound? It was his duty as trustee to represent and protect the holders of these bonds; and for that reason he was made a party, and he faithfully discharged that duty. It would be a new and very dangerous doctrine in the equity practice to hold that the *cestui que trust* is not bound by the decree against his trustee in the very matter of the trust for which he was appointed. If this complainant owned any of those bonds and coupons, then he is bound because he was representing himself. If he had bought them since, he is bound as privy to the person who was represented."

In Sahlgaard *v.* Kennedy (1882), 13 Fed. Rep. 242, the court did not decide, but intimated, that complainant, a bondholder, who had asked and was allowed to intervene in a State court, and resist the confirmation of a sale of the railroad property by the trustee under foreclosure, on alleged charges of unfaithfulness to the trust on the part of the trustee, would be estopped thereby as to asking the United States court on such grounds to set aside the decree of sale of the State court.

[2] Beals *v.* Ill., Miss. & Tex. R. Co. (1886), 27 Fed. Rep. 721; on appeal (1890), 133 U. S. 290.

[3] Pollitz *v.* Farmers' Loan & Trust Co. (1893), 53 Fed. Rep. 210.

§ 496. **The Binding Effect of the Trustee's Acts extends to Acts of Discretionary Character.** — This occurs where he decides that it is for the interests of the bondholders to begin suit, — especially if in doing so he is backed by the opinion of the majority of the bondholders;[1] or releases errors in the foreclosure proceedings and decree, and waives the right of appeal;[2] or by appearing in a suit in which he is made defendant, has waived defects in the service of process;[3] or has decided that the interests of the bondholders will be best subserved by not having a sale until an appeal from the decree has been determined;[4] or it is agreed between the trustees of several mortgages that it will be for the best interests of the bondholders represented by them that the property shall be sold as an entirety.[5] So also, if the terms of the mortgage put no restraint upon the amount which the trustee may bid at the foreclosure sale in the exercise of the power conferred upon him of buying in the property for the bondholders, an order issued in the course of the proceedings with the consent of an intervening bondholder, whereby the trustee is directed to bid "up to" a certain sum, will not, as against that bondholder, be construed as limiting the discretion which the mortgage allows him in regard to the price which he may offer.[6]

So bondholders under a second mortgage cannot maintain a bill to set aside a sale of the property under foreclosure of the first mortgage, and annul a plan of reorganization of the first-mortgage bondholders, where they charge no collusion by or unfaithfulness of the trustee under the two mortgages in making the sale under the first mortgage.[7]

§ 497. **In what Matters Trustee cannot bind Bondholders.** — The bondholders are not represented by the trustee in an application for leave to invest the trust fund in a way not authorized by the trust deed, at least to such an extent that they would be bound by a judgment changing the investment without being actual parties to the proceedings, and having an opportunity

[1] Shaw *v.* Railroad Co. (1879), 100 U. S. 605, 612.

[2] Elwell *v.* Fosdick (1890), 134 U. S. 500; s. c. 43 Am. & Eng. R. R. Cas. 450.

[3] Cheever *v.* Rutland & Burlington R. Co. (1869), 4 Am. Ry. Rep. 291. The court remarked that, if the trustee sufficiently represents the bondholders to make his defence upon the merits conclusive upon them, his defence upon mere technical points must still more clearly be conclusive upon them.

[4] Farmers' Loan & Trust Co. *v.* Central Railroad Co. of Iowa (1877), 4 Dill. 533.

[5] First National Bank of Cleveland *v.* Shedd (1887), 121 U. S. 74.

[6] James *v.* Cowing (1880), 82 N. Y. 449; s. c. 2 Am. & Eng. R. R. Cas. 336.

[7] Robinson *v.* Iron Railway Co. (1890), 135 U. S. 522.

to contest the propriety of granting the relief asked for by the trustee.[1]

Nor are the bondholders obligated by the result of a suit brought to adjudge mortgage void, in which the trustee alone is served with process. There is nothing in the relation of the trustees and the bondholders which makes the former general agents or attorneys of the latter as to all matters affecting the bonds. The right to defend the validity of the bonds is personal to the owners of the bonds, and whenever that right is assailed they are entitled to protect their interests in their own persons and by their own counsel.[2]

§ 498. **Action of Trustee inures to Benefit of the Bondholders.** — The bondholders receive the advantages as well as the disadvantages of the principle that the trustee is their representative. Hence the commencement of a suit by him will have the effect of stopping the running of the Statute of Limitations.[3]

§ 499. **Remedies of Dissatisfied Bondholders after Rendition of the Decree.** — The propriety of a trustee's action cannot be tested by a bill of review. The complaining bondholders must bring an action directly against the trustee.[4] Nor can the bondholder commence an independent and original suit to foreclose as long as the decree remains in force.[5] His proper remedy, where the decree or the sale thereunder is in fraud of his rights, is by a direct proceeding to set aside the sale or the decree.[6]

Such a proceeding may take the form of an application to be allowed to intervene and become actual parties to the former suit, the court being then asked for such relief as it is competent for parties to make in the same suit; or the bondholder may effect his purpose by instituting such other auxiliary, reversionary, or supplemental proceedings as a party to the suit may institute.[7] The bondholder who seeks for this relief must use due diligence. He will not be allowed to become a party to the original suit for the purpose of impeaching the decree, when he has remained

[1] Clark *v.* St. Louis, Alton, & Terre Haute R. Co. (1879), 58 How. Pr. 21; Fidelity Ins. Trust & Safe Deposit Ins. Co. *v.* United New Jersey Railroad & Canal Co. (1883), 36 N. J. Eq. 405; s. c. 12 Am. & Eng. R. R. Cas. 404.

[2] Appeal of Harrisburg R. Co. (Pa. St., Oct., 1888), 36 Am. & Eng. R. R. Cas. 249.

[3] *In re* Chickering (1883), 56 Vt. 82; s. c. 26 Am. & Eng. R. R. Cas. 646.

[4] Shaw *v.* Railroad Co. (1879), 100 U. S. 605, 612.

[5] Richter *v.* Jerome (1887), 123 U. S. 233, 247; Campbell *v.* Railroad Co. (1871), 1 Woods, 368.

[6] Richter *v.* Jerome (1887), 123 U. S. 233, 247.

[7] Campbell *v.* Railroad Co. (1871), 1 Woods, 368.

inactive during five years of litigation, and not only has the sale been confirmed, but the purchasers have been reorganized as a new corporation, and, as such corporation, have issued bonds to *bona fide* holders.[1]

[1] Wetmore *v.* St. Paul & Pac. R. Co. (1880), 3 Fed. Rep. 177, 179. The court said there was no principle or precedent which would warrant granting a request which was tantamount to asking that the petitioners should be made parties, and then treated in the double aspect of persons who were parties to the suit, and had all the rights of parties from the beginning, and also in the aspect of persons who were not parties to the suit, and whose rights had not been foreclosed.

Besides those cases already cited upon the question of parties, see the following instructive cases: Craft *v.* Indianapolis, D. & W. R. Ry. Co. (1897), 46 N. E. Rep. 1132; *In re* The Continental Oxygen Co., Limited (1897), 76 L. T. R. N. S. 229; Roberts *v.* Denver, L. & G. R. Co. (1896), 46 Pac. Rep. 880.

Also, upon the subject of the right of intervention, see an article entitled "Interventions in the Federal Courts," in 31 Am. Law Review, at page 377; Wiltsie on Mortgage Foreclosure; and the following cases: Hyman *v.* Cameron, 46 Miss. 726; Lacroix *v.* Menard, 15 Am. Dec. 161; Brown *v.* Saul, 16 Am. Dec. 177; Gould *v.* Mortimer, 16 Abb. Pr. 448; Schenck *v.* Ingraham, 5 Hun, 397; People *v.* Albany & Vermont Ry. Co., 77 N. Y. 232; Doe *v.* Childress, 21 Wall. 642; Horn *v.* Volcano Water Co., 13 Cal. 62; Speyer *v.* Ihmels, 21 Cal. 280; Gradwohl *v.* Harris, 29 Cal. 154; Farmers' Loan & Trust Co. *v.* Central Ry. Co., 17 Fed. Rep. 758; Farmers' Loan & Trust Co. *v.* Miss., I. & N. Ry. Co., 21 Fed. Rep. 264; French *v.* Gapen, 105 U. S. 509; Williams *v.* Morgan, 111 U. S. 685, 698, 699.

CHAPTER XXV.

CONTROL AND DISPOSITION OF THE MORTGAGED PROPERTY WHILE THE COMPANY IS IN POSSESSION.

Article I. — Control of the Corpus of the Property.

§ 500. **Control usually left to Mortgagor by Terms of Mortgage.** — The management and control of the property subject to an ordinary trust mortgage is by the terms of the instrument usually left in the grantor until condition broken. Where this is the case the company, and not the trustee, is the proper plaintiff in an action to enforce rights in regard to land embraced by the mortgage.[1]

[1] Southern Pacific R. Co. *v.* Doyle (1882), 11 Fed. Rep. 253. This case was decided with reference to the California Code, which, it was contended, changed the rule that the mortgagee is, until possession taken, only the owner in a very limited sense. The court, however, said that, although a trust is necessarily raised, where a power of sale is conferred on any person other than the parties secured, it does not necessarily follow that the trustee has a right of possession, at least until condition broken. Even if the instrument in question were strictly a trust deed rather than a mortgage, the result would be the same; for no right was conveyed by it to the possession, etc. of the land until after default and a demand by the bondholders.

Where, in addition to the ordinary provision by which the undisturbed possession of the premises conveyed is reserved to the mortgagor, it is also stipulated that nothing in the deed "shall be construed so as to prevent the corporation from improving the real estate or making leases of such parts thereof as they may desire and have an opportunity to make, any lease made by the mortgagor will remain valid as long as the condition of the mortgage is performed by the payment of interest, but will cease to have any validity against the mortgage after condition broken, while a lease not made till after condition broken is altogether unauthorized.[1]

§ 501. **Right to mortgage Property already charged by Way of "Floating Security."** — Debenture-holders for whose protection the whole property of a company, both present and future, is charged "by way of floating security," the company having the right to deal with the property until after the continuance of a default of the interest for three months, will be postponed to bondholders, secured by a mortgage executed while the company is still in control of the property, although there has been a three months' default in the interest. Even after the expiration of that period the security of the debenture-holders remains a floating security merely, until they take some steps to enforce it and stop the company from carrying on its business. Otherwise the consequence would follow, that the debenture-holders could, if they chose, allow the company to go on after the three months, allow debts to be contracted, and then say that none of them shall be paid, although the company is still carrying on its business.[2]

§ 502. **Liability of the Mortgaged Property to be levied on.** — The extent of the protection afforded to the mortgagee's interest by the mortgage clearly depends upon the scope of the lien, and upon the validity of the transaction by which it is created, and must therefore be determined by an examination of the cases reviewed in another part of this treatise. (See Chapter VII., etc.) The existence of the mortgage lien necessarily involves the consequence that the rights of the bondholders should not be allowed to suffer any prejudice from legal proceedings to enforce later claims. But the authorities are scarcely in harmony as to the proper method for rendering this protection practically effective.[3]

The fact that the mortgagor is a corporation does not in any way limit the right of a judgment creditor to subject the mort-

[1] Haven *v.* Adams (1862), 4 Allen, 80.

[2] Governments Stock Invest., etc. Co. *v.* Manila R. Co. L. R. (1895), 2 Ch. 551.

[3] See Chap. XX. (preventive remedies).

gaged property to the payment of his claim, for property which a debtor has a right to dispose of by a voluntary alienation must necessarily be liable to involuntary alienation.[1]

Questions arising under this head must be carefully distinguished from those in which the corporate property is deemed to be protected by the fact of its being essential to the exercise of the franchises, and not by the fact of its being mortgaged. As railroad mortgages ordinarily run, all the property entitled to protection for the former reason is also entitled to protection for the latter reason. The distinction is important in so far that, where the former reason is relied upon, the question of immunity from levy can be, and in most if not all of the cases has been, raised by the company itself, while the extent of the protective power of the mortgage concerns only the mortgagee and the levying creditor. A discussion of the first class of cases does not fall within the legitimate scope of a treatise dealing with the rights and liabilities arising out of the mortgage contract itself.

§ 503. **Power of the Judgment Creditor to sell the Mortgagor's Equity of Redemption.**— Whatever may be the extent and character of the protection afforded by the mortgage as regards the property itself, it is clear that a judgment creditor may always reach the mortgagor's equity of redemption, either by proceedings of an equitable nature, or by execution where that is permitted by the practice of the court.[2]

A railroad company cannot defeat this right of a creditor by executing a deed of trust with a long time to run. To hold this would amount to "a recognition of a right in the company to secure itself in the possession and enjoyment of its property, and compel all who become its creditors to resort to the means provided by that instrument for their payment, and not to those given by the law to all who choose to invoke its aid against a defaulting debtor."[3]

[1] Ludlow *v.* Clinton Line R. Co. (1861), 1 Flip. 25; s. c. 15 Fed. Cas. 1099, Case No. 8600.

[2] See Freeman on Executions, §§ 117, 382.

[3] Vicksburg & Meridian R. Co. *v.* McCutchen (1876), 52 Miss. 645. This case was decided more especially in reference to the Mississippi Code; but the reasoning of the court is quite general, the following language of the Ohio court being cited with approval: "Those who take a mortgage upon property to secure a loan for a long period of time, however desirable it may be to have the arrangement carried out, may be disappointed owing to an imperfection incident to such an arrangement, — an imperfection resulting from the policy of the law, — that parties cannot be permitted to retain indefinitely the use and enjoyment of property by simply giving a security upon it for the payment of their debt. The property must be subject in some form to the first claims of the party subsequently arising, and this will frequently and necessarily lead to an inter-

This Mississippi statute referred to in the note indicates what is undoubtedly the proper procedure for the practitioner, whether the legislature has expressly prescribed it or not, for the cases cited in chapter on preventive remedies show that the litigation will always be drawn into a court of equity by the bondholders if their interests, as is usually the case, are endangered by the levy. To resort to a court of law under such circumstances is simply to run the risk of incurring useless expense.

Besides, it is manifest that, for the same reasons which have led courts of equity to assume jurisdiction of trustees' suits for possession (see the chapter on that subject), those courts offer the only suitable forum for the adjustment of the manifold rights which will be affected by an execution sale of the residuum of the mortgagor's interest; and even if the bondholders should not think fit to interfere, a much more satisfactory settlement can be obtained by applying for equitable relief in the first instance.

Article II. — Control and Disposition of the Income.

§ 504. **Company entitled to dispose of the Income while it is in Possession, even though such Income is expressly pledged.** — The rights of the mortgagee in regard to the avails of the mortgaged property stand upon a different footing from his rights in regard to the property itself. So long as the mortgagor is allowed to remain in possession he is entitled to receive and apply to his own use the income and profits of the mortgaged estate.

If, therefore, a mortgagor corporation has leased a portion of the property, it can contract as it chooses in regard to the rents with an assignee of the lease.[1]

It has been strenuously contended in several instances that the insertion in the mortgage of a provision by which the income of the property is specifically pledged supersedes the common-law rule. But this theory has been discredited in almost every court in which it has been presented, and it is now well established that, if the mortgagor company is given, either expressly or by implication, the right to remain in possession of the estate until a

ruption and disappointment in a prior arrangement as to the time within which it is to be performed." Coe *v.* Columbus, Piqua, & Indianapolis R. Co. (1859), 10 Ohio St. 372, 401.

The equity of redemption was made by the Mississippi Code subject to execution (§ 2295); but a later statute provided that the Chancery Court should have exclusive jurisdiction in all cases when that equity is sought to be sold.

[1] Frank *v.* New York, Lake Erie, & Western R. Co. (1891), 122 N. Y. 197; s. c. 25 N. E. Rep. 335; 46 Am. & Eng. R. R. Cas. 356.

default occurs, it is entitled to control the use of the earnings, as long as the mortgagees allow its possession to continue. In a case where a mortgage of this description was under review the Supreme Court of the United States said: "It is clearly implied in these mortgages that the railroad company should hold possession and receive the earnings until the trustees should take possession or the proper judicial authority should interpose. Possession draws after it the right to receive and apply the income. Without this the road cannot be operated, and no profit could be made. Mere possession would be useless to all concerned. The right to apply enough of the income to operate the road will not be questioned. The amount to be so applied was within the discretion of the company. The same discretion extended to the surplus. It was for the company to decide what should be done with it. In this condition of things the whole fund belonged to the company; it was subject to its control. It was, therefore, liable to the creditors of the company, as if the mortgages did not exist. If the mortgagees were not satisfied, they had the remedy in their own hands, and could at any moment invoke the aid of the law, or interpose themselves without it." [1]

[1] Gilman *v.* Illinois & Miss. Tel. Co. (1875), 91 U. S. 603; s. P. Galveston Railroad *v.* Cowdrey (1870), 11 Wall. 459; American Bridge Co. *v.* Heidelbach (1876), 94 U. S. 798; United States Trust Co. *v.* Wabash & Western R. Co. (1893), 150 U. S. 287; Kountze *v.* Omaha Hotel Co. (1882), 107 U. S. 378; Teal *v.* Walker (1884), 111 U. S. 241; Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1887), 30 Fed. Rep. 332; Fosdick *v.* Schall (1879), 99 U. S. 235; Mercantile Trust Co. *v.* Missouri, K. & T. R. Co. (1888), 36 Fed. Rep. 221. See also Gibert *v.* Washington City, Va. Midl. & Grt. Southern R. Co. (1880), 33 Gratt. 645; Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush (Ky.), 673; s. c. 18 Am. Ry. Rep. 233. The rule as to other corporations is the same. Freedman's Savings & Trust Co. *v.* Shepherd (1888), 127 U. S. 494. In view of these rulings the statement of the court in Douglass *v.* Cline (1877), 12 Bush (Ky.), 608, that a mortgagee who has no specific pledge of the profits of the mortgaged premises cannot claim them as a legal incident or a legal right growing out of his mortgage, seems to be unduly cautious, even to the extent of implying an erroneous doctrine.

The decisions in two Iowa cases—Jessup *v.* Bridge (1861), 11 Iowa, 572, and Dunham *v.* Isett (1863), 15 Iowa, 284 — are to the effect that a positive stipulation of this character gives the mortgagees a specific lien on the net earnings, which can be enforced against other creditors. These rulings were made before the doctrine of the Supreme Court of the United States and of other courts had been established by the cases referred to above, and can hardly be deemed authorities outside the State of Iowa itself. The clause allowing the company to remain in possession till after default has been regarded in another case as an affirmative covenant, which, whatever may be the effect of the granting clauses, amounts to a re-demise, and therefore, as respects the necessary expenses of operation, gives the company the right to contract for articles required to keep up the road as a going concern. Parkhurst *v.* Northern Central R. Co. (1862), 19 Md. 472. This is an early case, and, in view of later decisions, needlessly circumscribed in its scope.

The usual clause giving the trustee a right to take possession of the property after default is merely intended to "define and point out the manner in which the pledge of the tolls and income is to be carried into effect;"[1] and as the terms of the mortgage thus explicitly declare the mode in which the mortgagees may reach and control the use of the corporate property and franchises, and appropriate the income thereof, no lien or priority of claim upon such income can be acquired in any other mode.[2]

The mere fact that the mortgage makes it the duty of the company to apply the income, after paying the current expenses, to the liquidation of the interest does not create an obligation which "of its own force carries title to the particular money received as income, any more than the obligation to pay a debt in ordinary cases carries to the creditors a title to the money in the debtor's pocket. The fact that the mortgagor is in possession, operating the road, renders it indispensable that he shall pay current expenses and necessary repairs and improvements, and that he shall exercise his judgment and discretion as to the extent to which repairs and improvements shall be made; and this can only be paid out of the income. It is inconsistent with such control over the income that it shall be the property of the trustees."[3]

Possibly the doctrine of the cases cited in this section may be arrived at more directly by considering that the possession to which the mortgagee is entitled is, as regards the *corpus* of the property, merely prospective and dependent upon certain contingencies, and that, in the absence of words clearly evincing a contrary intention, the same principle of construction ought to be applicable to the rents and profits. To deduce such an intention from words which merely give the trustee the rights of a common-law mortgagee under certain circumstances, would obviously be a very strained construction of the contract.

§ 505. **Same Rule as against Holders of Income Bonds.** — The holders of income bonds the interest of which is payable out of the "net earnings" remaining after satisfying the operating expenses and prior claims in each interest period, cannot object to the management of the road in the usual manner, according to the discretion and judgment of the directors. The mortgage contract, therefore, does not prevent the mortgagor from

[1] Galveston Railroad *v.* Cowdrey (1870), 11 Wall. 459, 483.

[2] Ellis *v.* Boston, Hartford, & Erie R. Co. (1871), 107 Mass. 1.

[3] Miss. Valley & Western Ry. Co. *v.* United States Express Co. (1876), 81 Ill. 534. Similar reasoning may be found in De Graff *v.* Thompson (1878), 24 Minn. 452; s. c. 5 Rep. 561.

leasing the road to another company, even though the arrangement involves a reduction in the amount available for the payment of the interest on the bonds.[1]

§ 506. **Specific Appropriation of the Income, which will prevail against all other Claims.** — This may, of course, be effected by the terms of the instrument creating the lien. Such was the effect of the Missouri statute which authorized St. Louis County to issue county bonds in aid of the Pacific Railroad Company. It was held that a provision in that statute declaring that the official who should have charge of the funds of the company was to pay into the county treasury every month a specific portion of the earnings, created, when the benefits of the statute were accepted, an equitable lien to that extent upon those earnings, and that this lien was enforceable not only against the receiver appointed in a subsequent foreclosure suit instituted by another incumbrancer, but also against the purchaser under the decree in that suit, and any one who might hold the property or have the custody of its earnings.[2]

§ 507. **Stockholder's Right to a Dividend when complete as against the Mortgagor.** — Dividends can be paid only out of net profits; and the right to declare a dividend depends on the state of the company's finances at the time when the dividend is declared.

The control of the income by the company involves a right to distribute a portion of the surplus funds remaining after the expenses and the interest on the bonds and other debts have been paid; and if the directors, in the exercise of a proper discretion, have once declared and set apart a dividend in such a manner as to constitute an equitable assignment of the money, it ceases to be a part of the corporate assets, and therefore cannot be reached by the bondholders. Thus, if the directors have deposited in a bank a sufficient sum to pay a dividend previously declared, the appropriation of the money to the stockholders is complete, and the right of a stockholder to draw his proportion thereof at any time will not be defeated by the subsequent appointment of a receiver.[3]

[1] Day *v.* Ogdensburgh & Lake Champlain R. Co. (1888), 107 N. Y. 129; s. c. 13 N. E. Rep. 765; 35 Am. & Eng. R. R. Cas. 102, reversing s. c. (1886), 42 Hun, 654; s. c. 1 Ry. & Corp. L. J. 70.

[2] Ketchum *v.* St. Louis (1879), 101 U. S. 306.

For other cases in which the effect of a statute declaring a lien in favor of the State was held to have the effect of specifically appropriating the net earnings to the payment of interest, and thus precluding any levy on such earnings until their paramount claim had been satisfied, see MacAlester's Admr. *v.* Maryland (1885), 114 U. S. 598; s. c. 5 Sup. Ct. Rep. 1065; Brady *v.* State (1866), 26 Md. 290.

[3] In the Matter of Le Blanc (1878), 14 Hun, 8; affirmed without comment in 75 N. Y. 598.

§ 508. Income of Road may be attached or levied upon by Creditors while the Mortgagor is in Possession. — The mortgagor's right to control the income while in possession carries with it the usual incident of ownership, viz., that it may be subjected to the payment of his debts. A creditor, therefore, by attaching the avails of the property in the hands of the mortgagor will ordinarily obtain a lien thereon which is paramount to that of the mortgage.[1]

The rights of the creditor are fixed when judgment is recovered and execution sued out, and the mortgagee obtains no title to a fund derived from this source merely for the reason that a receiver is appointed before the creditor has actually appropriated the amount due to him.[2]

The right of creditors with claims coming under the head of operating expenses to attach the earnings is sometimes strengthened by provisions in the mortgage. Thus where the company is expressly authorized to remain in possession until default, and to apply any of the income or personal property to the construction or repair of the road, or to its current expenses, or payment of debts, and to pay dividends out of the net profits, after deducting enough for interest and a sinking fund, the implication is that the receipts of the road do not come under the lien of the mortgage until the net profits have been ascertained. Before default, therefore, a creditor whose claim comes under the head of current expenses may attach tolls belonging to the road.[3]

[1] Gilman *v.* Illinois & Miss. Tel. Co. (1875), 91 U. S. 603, 616; De Graff *v.* Thompson (1878), 24 Minn. 452; Smith *v.* Eastern Railroad Co. (1888), 124 Mass. 154; Merchants' Bank *v.* Petersburg Railroad Co. (1877), 12 Phil. 482; Mississippi Valley & Western Ry. Co. *v.* U. S. Express Co. (1876), 81 Ill. 534; Ellis *v.* Boston, Hartford, & Erie R. Co. (1871), 107 Mass. 1; Gibert *v.* Washington City, Va. Midl. & Grt. Southern R. Co. (1880), 33 Gratt. 645; s. c. 1 Am. & Eng. R. R. Cas. 512 (1881); Parkhurst *v.* Northern Central R. Co. (1862), 19 Md. 472.

[2] Gibert *v.* Washington City, Va. Midl. & Grt. Southern R. Co. (1880), 33 Gratt. 645; s. c. 1 Am. & Eng. R. R. Cas. 512.

In Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush (Ky.), 673; s. c. 18 Am. Ry. Rep. 221, one of the general creditors, the Western Bank, had recovered a judgment against the company before the appointment of the receiver, and, upon a return of *nulla bona*, undertook to levy an attachment, according to the provisions of the Kentucky Code of Practice (§ 474), by serving on the president of the company a copy of the process, on which was indorsed the object of the action, viz., to appropriate "the income, etc." to the payment of the judgment. It was held, however, that a notice of this kind did not affect the power of the officers of the company to exercise a reasonable and proper discretion as to the order in which debts should be paid. At all events, the delivery of the summons to the president was but equivalent to service on the company itself, and there was no section of the code providing that an attachment lien on intangible property might be created by the service of any character of process on the judgment defendant alone.

[3] Clay *v.* East Tenn., Va. & Ga. R. Co. (1871), 6 Heisk. 421; s. c. 12 Am. Ry. Rep. 38.

The creditors of the company may reach by garnishment process all income accruing prior to default, even when it has passed into the hands of the mortgagees, if the latter have appropriated it without the consent of the company.[1]

§ 509. **When the Mortgagee's Right to the Income becomes absolute in Suits for Possession.** — Under a mortgage of the ordinary form entitling the trustee to take possession upon a default, the possession of the company is unlawful from the time when it fails to comply with a demand of the trustee to surrender the property, and cannot thereafter furnish a foundation for any rights which are dependent on its legality. The trustee is, therefore, entitled to all earnings which accrue after a demand for possession, and the institution of a suit for possession is equivalent to a demand. It is immaterial that no receiver is appointed for some time after the commencement of the proceedings. The company itself is to be treated in all respects from the time the suit is begun as a receiver of the property, holding it for the benefit of whomsoever it may in the end be found to concern.[2]

After the possession of the trustees is perfected, they are entitled to receive all sums earned through the operation of the road; as the rentals of a leased line,[3] and moneys due for carrying the mails collected by an agent of the company.[4]

Whatever net earnings are found in the possession of the trustee at the time of the foreclosure are properly applied to the reduction of the mortgage indebtedness.[5]

If necessary, the earnings will be apportioned between the trustee and an attaching creditor. Thus where the trustee takes possession during the currency of a month, at the end of which the company is to be entitled to receive a sum of money, as compensation for services performed under a contract, entered into after the execution of the mortgage and not covered by it, the money will be apportioned so as to give an attaching creditor

[1] De Graff *v.* Thompson (1878), 24 Minn. 452; s. c. 17 Am. Ry. Rep. 183.

[2] Dow *v.* Memphis & Little Rock R. Co. (1888), 124 U. S. 652; s. c. 33 Am. & Eng. R. R. Cas. 12. Compare Galveston Railroad *v.* Cowdrey (1870), 11 Wall. 459, where the Supreme Court of the United States, in upholding the right of a creditor to levy on the earnings accruing before suit brought, said that it did not "appear that the complainants or their trustees made any demand for the tolls and income till they filed the present bill," and that "the bill itself did not contain any allegation of such a demand."

[3] King *v.* Housatonic R. Co. (1877), 45 Conn. 226.

[4] Murray *v.* Deyo (1877), 10 Hun, 3. There the agent for collection undertook to hold the money collected as a set-off against a claim which he had against the company; but the court refused to allow him to do so.

[5] Wood *v.* Whelen (1879), 93 Ill. 153 (not a railroad case).

the part which was earned during the time which elapsed between the beginning of the month and the entry of the trustee.[1]

The principle that the trustees are entitled to the income after taking or demanding possession necessarily involves the corollary that money earned by the operation of the road, while they are actually or constructively in possession, cannot be reached by garnishment in the hands of the debtor by a creditor of the latter.[2]

§ 510. **When the Mortgagee's Right to the Income becomes absolute in Suits for Foreclosure.** — Ordinarily the assumption of control by a receiver in a foreclosure suit has the effect of sequestrating the earnings for the benefit of the mortgagee from that time onward.[3]

But the terms of the mortgage may be such as lead to the conclusion that the bondholders have no right to the earnings until actual entry by the trustee. In this case even the appointment of a receiver in a foreclosure suit instituted on their behalf does not give them any priority of claim as regards the earnings thereafter accruing.[4]

The possession of the receiver for the purpose of cutting off the right to levy on the earnings is not complete until he has given the required security for the faithful discharge of his duties.[5]

§ 511. **Effect of the Divestiture of the Company's Control in a Suit brought by a Party other than the one claiming the Earnings.** — To entitle a mortgagee to income accruing after the control of the company ceases, it is not necessary that such control should have

[1] Emerson *v.* European & North American R. Co. (1877), 67 Me. 387.

[2] Galena & Chicago Union R. Co. *v.* Menzies (1861), 26 Ill. 121. This case has sometimes been cited as countenancing the broader proposition that income specifically pledged is no longer under the control of the mortgagor; but in a later case in the same court (Mississippi Valley & Western Ry. Co. *v.* U. S. Express Co. (1876), 81 Ill. 534) the possession of the trustees was stated to be the distinguishing feature which determined the rights of the parties.

[3] Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush (Ky.), 673; 18 Am. Ry. Rep. 221.

[4] Ellis *v.* Boston, Hartford, & Erie R. Co. (1871), 107 Mass. 1. There the trust deed provided for entry after default, and the receipt thenceforward of the income by the trustees, and also declared that, on taking possession, they should file a written notice of the fact in the office of the secretaries of State in the three States over which the railroad extended. The court thought that this explicit language excluded the possibility of acquiring a lien on the income in any other mode than the one stated.

[5] Frayser's Admrs. *v.* Richmond & A. R. Co. (1886), 81 Va. 388, relying on Edwards *v.* Edwards (2 L. R. Ch. Div. 291), where it was held that a levy on goods before the receiver had given security or taken possession was not a contempt of court. Such also seems to be the rule in Maine: Noyes *v.* Rich (1861), 52 Me. 115; though the point is only passed on by implication.

been terminated at his own instance, provided his own right be superior to that of the party actually moving in the matter, and he has taken active steps to enforce his claim. Thus if a senior mortgagee is made a party to a suit brought by a junior incumbrancer to foreclose his lien, and a receiver is appointed upon the application of the latter, the senior mortgagee may obtain an order directing the receiver to hold for and to pay to them so much of the net earnings as are covered by their mortgages.[1]

On the other hand, if a receiver has been appointed at the instance of a judgment creditor for the protection of his own interests, and not for the interests of the trustees, bondholders, and other creditors, the trustees cannot have the net earnings of the property, while in the hands of such receivers, applied to the discharge of the bondholders' claims, unless they have previously demanded possession or intervened in the suit.[2]

So, also, where a receiver has been appointed in a suit to foreclose a general mortgage covering a system composed of several divisions, some of which are subject to prior underlying mortgages and others are not, the bondholders secured by underlying mortgages cannot object to the disposition of the income prior to the time when they commence proceedings to enforce the lien, and have the money used for the payment of preferential claims taxed by receivers' certificates, or in some other way, upon the earnings of the divisions upon which there are no prior liens. Especially must such relief be denied them after the rendition of a decree to which their trustees have assented.[3]

There is some authority for carrying this principle still further, and holding that the mortgagee's contingent right to the income matures immediately after the possession of the company is terminated by the institution of proceedings by any of the creditors, although the mortgagee does nothing to assert his right, and allows the assignees of the corporate property to go on receiving the income for several years before attempting to enforce his lien. Thus it has been held that where a portion of a road is subject to a mortgage which embraces income, and a later mort-

[1] Seibert v. Minneapolis & St. Louis R. Co. (1893), 52 Minn. 246; s. c. 53 N. W. Rep. 1151.

[2] Sage v. Memphis & Little Rock R. Co. (1888), 125 U. S. 361; s. c. 35 Am. & Eng. R. R. Cas. 40.

[3] Central Trust Co. v. Wabash, St. Louis, & Pac. R. Co. (1887), 30 Fed. Rep. 332. Apart from certain special reasons based upon the circumstances presented for review, Judge Brewer based his ruling on the broad ground that such relief "would not be right; because the mortgagor has by the settled law of this country absolute control of the income of his property prior to the legal proceedings instituted by the mortgagee."

gage on the whole property is foreclosed, and the property sold, subject to the divisional lien, the purchaser will hold the income derived from the section covered by the prior mortgage in trust for those protected by it, and upon being brought in as a defendant in a suit long afterwards instituted by the representative of the senior mortgagees, may be compelled to account for that income for the period between the date at which he took possession and that at which the second suit was instituted.[1]

[1] Pullan *v.* Cincinnati & Chicago Air Line R. Co. (1873), 5 Biss. 237; s. c. 20 Fed. Cas. 38, Case No. 11,462. It seems very doubtful whether, in view of the subsequent decisions of other courts, this ruling can be sustained. There is apparently no valid reason why any distinction should be made between the cases in which the road is operated by the mortgagor, and those in which it is operated by an assignee. In either event the earnings are essential for the purpose of carrying on the business, and the mortgagee secured by the income, if he takes no steps to assert his rights, must be presumed to have assented to the control of those earnings by the party in possession at the time being.

CHAPTER XXVI.

APPOINTMENT, REMOVAL, AND DISCHARGE OF RECEIVERS.

§ 512. **Introductory.** — As a receiver is almost invariably asked for in proceedings for the enforcement of railroad mortgages, and the peculiar nature of the property of which the court thus assumes control has developed some distinctive and novel applications of the familiar principles by which this branch of equity practice is governed, it is necessary to review the cases in which the appointment and functions of receivers in railway foreclosures have been considered in order to a systematic treatment of the questions connected with railway bonds, although the subject of receiver has been fully treated in numerous other works.

ARTICLE I. — APPOINTMENT OF RECEIVERS GENERALLY.[1]

§ 513. **With what Object a Receiver is appointed.** — A receiver is an indifferent person between parties appointed by the court to receive the rents, issues, or profits of land or other things in

[1] See Receivership of Corporations, by George A. Mercer, 3 Ga. Bar Association, 121; Receivers of Railways, by Leonard A. Jones, 4 So. L. Rev. N. S. 18; Railroad Receiverships, by M. M. Kohn, 19 Am. L. Rev. 400; Railway Receivership, note, 20 Am. L. Rev. 749; The Courts as Railway Managers, by Lawrence Gookin, 32 Alb. L. J. 45; Receivers in Mortgage Foreclosure, by James M. Kerr, 23 Am. L. Rev. 56; The Wabash Receivership, note, 21 Am. L. Rev. 798; Railway Receiverships, 24 Am. L. Rev. 668; The Court Management of Railroads, by Seymour D. Thompson, 27 Am. L. Rev. 481; Jurisdiction to appoint a Receiver on Petition of Debtor, note, 28 Am. L. Rev. 925; Federal and State Jurisdiction; Appointments of Receivers, note, 27 Am. L. Rev. 615; The Commercial Basis for Railway Receiverships, by Thomas L. Greene, 33 Am. Law Reg. & Rev. 417; Railroad Receiverships in the Federal Courts, address by Hon. Henry C. Caldwell, Judge U. S. Circuit Court of Appeals, 8th Dist., 30 Am. L. Rev. 161.

question, pending the suit, where it does not seem reasonable to the court that either party should do it.[1]

He is appointed for the benefit of all the parties interested, and not for the benefit either of the plaintiff or defendant, or of any individual litigant, where there are several on one or both sides.[2]

By means of the appointment a court of equity takes possession of the property which is the subject of the suit, preserves it from waste and destruction, secures and collects the proceeds or profits, and ultimately disposes of them according to the rights and priorities of those entitled, whether regular parties to the cause, or only parties in interest, coming before the court in a seasonable time and due course of proceeding to assert and establish their pretensions.[3] Such appointment is analogous to proceedings in attachment in a court of law, and has been styled an equitable execution.[4]

But there is a material distinction between the two remedies. The appointment of a receiver, though a kind of equitable execution, results in a merely general, not a specific, appropriation of the issues and profits of the subject-matter. It does not in itself give to the party applying for it any advantage over other claimants, but operates prospectively upon the rents and avails which

[1] Booth *v.* Clarke (1854), 17 How. 322, 331 (per Swayne, J., quoting Wyatt's Pac. Reg. 355).

A holder of debentures covering all the property of a company is entitled to a receiver notwithstanding that a creditor's petition has been previously presented to wind up. Strong *v.* Carlyle Press (1892), 2 R. 283.

An express provision in an order of incorporation that mortgagees may enforce payment by the aid of a receiver does not preclude them from obtaining a winding-up order. *In re* Portstewart Tramway Co. (1896), 1 Ir. R. 265.

Where certain assets are of an exceptional character, requiring a person of special knowledge to deal satisfactorily with them, such a person will be appointed receiver in respect thereof, leaving the ordinary assets to the official receiver to deal with. Industrial & General Trust *v.* South American & M. Co. (1894), 7 R. 64; 1 Ch. 108.

Where debenture-holder's security is endangered, the court will sometimes appoint a receiver and manager, though the interest is not due and time for payment has not arrived. Edwards *v.* Standard Rolling-Stock Syndicate (1893), 3 R. 226; Thorn *v.* Nine Reefs (1892), 67 Law Times, 93; *In re* Victoria Steamboats, Limited (1896), L. R. 1897, Ch. Div. 158.

A receiver appointed generally, and directed also to act as manager for a limited period, when the period expires he should apply for an extension as manager only. Davies *v.* Vale of Evesham Preserves (1895), 73 L. T. 150.

[2] Williamson *v.* New Albany, etc. R. Co. (1857), 1 Biss. 198, 205.

[3] Beverley *v.* Brooke (1847), 4 Gratt. 187, per Baldwin, J.

[4] Jeremy's Eq. Jurisp. 249; Cincinnati, Sandusky, & Cleveland R. Co. *v.* Sloan (1876), 31 Ohio St. 1. "Every kind of property of such a nature that, if legal, it might be taken in execution, may, if equitable, be put into the receiver's possession." Davis *v.* Gray (1872), 16 Wall. 203, 217 (per Swayne, J.).

may come into the hands of the receiver, as a lien in favor of those interested therein.[1] A receiver may be appointed at any stage of a foreclosure suit, even after the final decree.[2]

§ 514. **Reluctance of the Courts to appoint a Receiver.** — The court, acting as it must often of necessity do before the merits of the cause have been fully developed, and not infrequently when the proper parties in interest are not all before it, proceeds with much caution and circumspection, in order to avoid disturbing unnecessarily or injuriously legal rights and equitable priorities.[3] To begin by levying what is virtually an equitable execution on the property, and afterwards determine who is entitled to the benefit of this *quasi* process, is plainly a reversal to a great extent of the ordinary course of justice in an equitable tribunal.[4]

The reasons for proceeding with caution in the exercise of a summary jurisdiction of this peculiar sort are recognized to be especially strong in the case of a railroad company, a *quasi* public corporation operating a public highway. The principle upon which the courts act is, that a very strong case should be presented before they will grant a remedy so extreme, and, with reference to the management of the road, so revolutionary in its character.[5]

"The appointment of receivers to manage the affairs of a long line of railroad for five or six years is an exercise of judicial power which can only be justified by the pressure of absolute necessity."[6]

[1] Beverley *v.* Brooke (1847), 4 Gratt. 187.

[2] Gilman *v.* Illinois & Miss. Tel. Co. (1875), 91 U. S. 603.

[3] Beverley *v.* Brooke (1847), 4 Gratt. 187.

[4] Ibid.

[5] Sage *v.* Memphis & Little Rock R. Co. (1888), 125 U. S. 361; Farmers' Loan & Trust Co. *v.* Kansas City, W. & N. W. R. Co. (1892), 53 Fed. Rep. 182; State of Florida *v.* Jacksonville, P. & M. R. Co. (1875), 15 Fla. 201 (p. 286); Stevens *v.* Davison (1868), 18 Gratt. 819; Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467. The fact that railroad companies are in some sense public agencies may, however, in certain cases, be an additional reason for the assumption of control by the court, as where two companies are tenants in common of an easement, and it is represented that one is using the easement in such a manner as to render it less valuable to the other. Erie Ry. Co. *v.* Delaware, L. & W. R. Co. (1871), 21 N. J. Eq. 283, 288.

A receiver will be appointed of the property of a street-railway company when it appears necessary for the protection of all parties adversely claiming to be entitled thereto; thus a mortgagee of a portion of the railway and equipment is entitled to the appointment of a receiver, notwithstanding the addition to the assets and property by a subsequent transferee of the road, of new rolling-stock, horses, etc. Haley *v.* Halifax Street Ry. Co. (1893), 25 Nova Scotia, 140.

[6] Milwaukee & Minnesota R. Co. *v.* Soutter (1864), 2 Wall. 524 (per Miller, J.). Compare Pullan *v.* Cincinnati & Chicago Air Line R. Co. (1865), 4 Biss. 35, 47; Vermont & Canada R. Co. *v.* Vermont Central R. Co. (1877), 50 Vt. 500; Meyer

It has been contended that the appointment of a receiver to manage a railroad is against public policy, but this extreme view has been expressly negatived.[1]

But the courts, although theoretically unanimous as to the drawbacks of that solution of continuity in the management of a railroad which a receivership entails, have, on the whole, acceded with so much facility to applications for receivers, that more than one distinguished judge has deprecated the freedom with which this relief has been granted.[2]

v. Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467; Kelly *v.* Trustees, etc. (1877), 58 Ala. 489; 21 Am. Ry. Rep. 138.

[1] State *v.* Northern Central R. Co. (1861), 18 Md. 193.

[2] Justice Miller, in his dissenting opinion in Barton *v.* Barbour (1881), 104 U. S. 126, 137, expressed his dissatisfaction with the results of placing railroads in the hands of receivers for long periods, in the following vigorous language: "The rapid absorption of the business of the country of every character by corporations, while productive of much good to the public, is beginning also to develop many evils, not the least of which arises from their failure to pay debts and perform the duties which by the terms of their organization they assumed. One of the most efficient remedies for the failure to pay, when it arises from inability, is to place the corporation in the hands of a receiver, that its affairs may be wound up, its debts discharged, and the remaining assets, if any there be, distributed among its stockholders. Of the beneficial results of this remedy there can be little doubt. When it is applied with despatch, and the effects of the insolvent corporation are faithfully used to meet its liabilities, and its dead body is buried out of sight as soon as possible, no objection can be made to the procedure, and all courts and good citizens should contribute, as far as they may, to this desirable object. In regard, however, to a certain class of corporations, — a class whose operations are as important to the interests of the community and as intimately connected with its business and social habits as any other, — the appointment of receivers, as well as the power conferred on them, and the duration of their office, has made a progress which, since it is wholly the work of courts of chancery and not of legislatures, may well suggest a pause for consideration. It will not be necessary to any observing mind to say that I allude to railroad corporations. Of the fifty or more who own or have owned the many thousand miles of railway in my judicial circuit, I think I speak within limits in saying that hardly half a dozen have escaped the hands of the receiver. If these receivers had been appointed to sell the roads, collect the means of the companies, and pay their debts, it might have been well enough. But this was hardly ever done. It is never done now. It is not the purpose for which a receiver is appointed. He generally takes the property out of the hands of its owner, operates the road in his own way, with an occasional suggestion from the court, which he recognizes as a sort of partner in the business; sometimes, though very rarely, pays some money on the debts of the corporation, but quite as often adds to them, and injures prior creditors by creating a new and superior lien on the property pledged to them."

Almost more sweeping is the following expression of opinion by Judge Butler: "The modern practice of transferring corporate property to the custody of the courts, to be thus held and managed for an indefinite period of years, to suit the convenience of parties, I regard as a mischievous innovation." Taylor *v.* Phil. & Reading R. Co. (1881), 9 Fed. Rep. 1. See also the report of the case of the South Carolina Railroad in 11 Chicago Legal News, 8, where Judge Bond gives some statistics as to the disastrous results of some receiverships. See also 27 Am. Law Rev. 481.

In England, where a distinction is made between a mere receiver of rents and profits and a person who acts as a manager of the business, it was held, in a leading case,[1] that a court of equity would not appoint a functionary of the latter description to take charge of the property of a railroad company. In consequence of this decision, a statute was passed by which the powers of the courts of equity were made virtually identical with those which the courts of this country have not hesitated to exercise without any enabling act.[2]

§ 515. **Jurisdiction to appoint a Receiver.** — The power of a court of chancery to appoint a receiver *pendente lite* in foreclosure cases is a part of its incidental jurisdiction not depending on any statute.[3]

In some of the United States statutes have been passed authorizing the appointment of receivers, but it may fairly be questioned whether any positive advantages have been gained by these enactments. "There is no reason why the court of equity in the exercise of its undoubted authority may not accomplish all the best results intended to be secured by such legislation." [4]

[1] Gardner *v.* Railway Co., L. R. 2 Ch. App. 301.

[2] 30 & 31 Vict., ch. 127. See also 38 & 39 Vict., ch. 31. Under these acts a receiver manager may be appointed of the undertaking of a tramway company, as well as of a railway, in a suit to enforce overdue mortgage debentures. Bartlett *v.* West Metropolitan Tramway Co. (1893), L. R. 3 Ch. 437. See also Pegge *v.* Neath Tramways Co. (1895), L. R. 2 Ch. 509.

Debenture-holders, their security being a floating one on all the assets of a company, have a right to enforce their security through the appointment of a receiver, whenever the company ceases to be a going concern. Hubbuck *v.* Helms (1887), 56 L. T. N. S. 232.

But a railway company which has never commenced to acquire the lands or construct the railways authorized by its special act is not an "undertaking" within the meaning of section 4 of the former of these statutes, as it is applicable by its terms only to a going concern. *In re* Birmingham, etc. Ry. Co. (1881), L. R. 18 Ch. Div. 155; 3 Am. & Eng. R. R. Cas. 616.

The English doctrine as to the impropriety of a court's undertaking, without special statutory authority, to appoint a receiver to supersede permanently the managers of a railway, and to take entire charge of its affairs, was mentioned with approval in a New Jersey case. Delaware, Lackawanna, & Western R. Co. *v.* Erie Ry. Co. (1871), 21 N. J. Eq. 283, 298, citing Russell *v.* East Anglian Ry. Co., 3 Mac. & G. 125, and Fripp *v.* Chard, etc. Ry. Co., 11 Hare, 254.

[3] United States Trust Co. *v.* New York, W. S. & B. R. Co. (1886), 101 N. Y. 478; s. c. 5 N. E. Rep. 376; 25 Am. & Eng. R. R. Cas. 601; Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467; Davis *v.* Gray (1873), 16 Wall. 203, 219; Ford *v.* Kansas City & Independence Short Line Ry. Co. (1893), 52 Mo. App. 439; High on Rec., §§ 40, 41. In New York, where it was provided by statute (2 Rev. Stat. 463, § 38) that a receiver may be appointed in an equitable action instituted by the people for the dissolution of a corporation, it has been held that the powers and duties of such a receiver were not statutory, but merely were such as devolve on them by the orders of the court.

[4] Davis *v.* Gray (1873), 16 Wall. 203, 220.

As a general rule the power is one to be exercised by a trial and not an appellate court;[1] and where an appeal has been taken, the appointment of a receiver should ordinarily be made by the former.[2]

Under the statutes of Illinois the appointment of a receiver is invalid, unless made during the term.[3]

But an appointment made during vacation will be good, if afterwards confirmed during term time.[4]

A United States Circuit Court sitting within the district where a national bank resides has jurisdiction, without respect to the citizenship of the parties, to appoint a receiver of an insolvent railroad company in a suit brought by such bank. This power it possesses by virtue of the general jurisdiction of such courts over suits brought by or against national banks.[5]

In the case of the Northern Pacific Railroad, which runs through the districts of Wisconsin, Minnesota, Illinois, North Dakota, Montana, Idaho, Washington, and Oregon, with certain offices in New York, and its principal offices in Minnesota, proceedings in the form of a creditor's bill were originally instituted in the Eastern District of Wisconsin, where the company controlled certain lines of road under a long-term lease, the company appeared without objecting to the jurisdiction, and the court of that district appointed receivers. In all the other districts mentioned the courts appointed the same receivers in ancillary proceedings. The lease of the roads in Wisconsin was shortly afterwards cancelled by the lessors for non-payment of rent. The trustee of the bondholders filed in the same court a bill for foreclosure of their mortgage, and also ancillary bills in the courts of the other dis-

[1] High on Rec., § 41. In Tennessee, it would seem that the Supreme Court may, in a proper case, appoint a receiver pending an appeal. Kerr v. White (1874), 7 Baxt. 394. In Pacific Railroad of Missouri v. Ketchum (1877), 95 U. S. 1, the Supreme Court of the United States declined to decide whether a case might not arise in which they would exercise the power of appointing a receiver, pending an appeal, but were of opinion that they ought not to do so on the showing made in the case.

[2] May v. Printup (1877), 59 Ga. 128; s. c. 6 Rep. 392. The court said: "To us it seems very evident that either the Supreme Court or the Circuit Court must have power to preserve the property in litigation, and to prevent its waste and destruction. But for the Supreme Court to pass such interlocutory orders as might be necessary would be very inconvenient, if not impracticable. We know of no instance where it has been done. The Circuit Court acted with full knowledge of the facts and its practice in such cases. True, the case was in the Supreme Court; but the ultimate disposition of the property was to be through the Circuit Court. We think that court could grant such an order as it did."

[3] Hammock v. Loan & Trust Co. (1881), 105 U. S. 77.

[4] Hervey v. Illinois Midl. R. Co. (1884), 28 Fed. 169.

[5] Fifth Nat. Bank of Pittsburg v. Pittsburg & Castle Shannon R. Co. (1880), 1 Fed. Rep. 190.

tricts. The same receivers were again appointed in all the courts. Afterwards, in the district of Washington, the court, on a bill, held that the court in Wisconsin had never had or had lost its jurisdiction by the cancelling of the lease, leaving no property of the company within its territory, and removed the receivers.[1]

By petition the trustee and railroad company presented the matters and questions involved to Circuit Justices Field, Harlan, Brewer, and Brown, of the Supreme Court. Their opinion and judgment, after hearing all parties through their counsel, was thus stated: "We are of opinion that proceedings to foreclose a mortgage placed by a railroad company upon its lines, extending through more than one district, should, to the end that the mortgaged property may be effectively administered, be commenced in the Circuit Court of the district in which the principal operating offices are situated, and in which there is some material part of the railroad embraced by the mortgage; that such court should be the court of primary jurisdiction and of principal decree, and the administration of the property in the Circuit Court of other districts should be ancillary thereto." But under the circumstances of this case they determined that the court of the Eastern District of Wisconsin had jurisdiction to proceed to a decree of foreclosure which would bind the mortgagor company and the mortgaged property, and ought therefore to be recognized by the Circuit Courts of every district along the line of the road as the court of primary jurisdiction; and that proceedings in the latter courts, while protecting the rights of local creditors, should be ancillary in their character, and subordinate to the proceedings in the court of primary jurisdiction.[2]

As to conflicts of jurisdiction in suits asking for the appointment or removal of receivers, see Chapter XXI.

As to jurisdiction, so far as it depends upon the necessary parties being before the court, see Chapter XXIV.

As to the appointment of receivers in other States or districts, see § 525, *post*.

As to the removal of ancillary receivers, see § 549, *post*.

§ 516. **Who should be appointed Receiver.**[3] — Since a receiver acts as the representative of every one who has an interest in the subject-matter of the suit, it is of the first importance that he

[1] Farmers' Loan & Trust Co. *v.* Northern Pac. Ry. Co. *et al.* (1895), 69 Fed. Rep. 871.

[2] Farmers' Loan & Trust Co. *v.* Northern Pac. R. Co. *et al.* (1896), 72 Fed. Rep. 26, overruling Farmers' Loan & Trust Co. *v.* Northern Pac. R. Co. *et al.* (1895), 69 Fed. Rep. 871.

[3] See generally High on Rec., §§ 66 *et seq.;* Woods Ry. Law, 1652.

should be an impartial person. For this reason the fact that the proposed appointee is himself interested in the result of the litigation will usually be sufficient to cause his rejection. The general rule is that, unless in cases of imperative necessity, no person will be appointed receiver of a railway company who is a party to, or of counsel in, the cause, or who has been an officer in, or an official of, the insolvent corporation.[1]

A person connected with a firm who are counsel for complainant is ineligible to the appointment of receiver.[2]

A party defendant is an especially improper person to act as receiver.[3]

Nor ought a stockholder or director to be appointed under ordinary circumstances.[4]

In the case of directors, the objection to their appointment is based not merely on the improbability of their acting impartially, but also on the common-sense principle that a person who cannot with the aid of others manage a business successfully, is *prima facie* unfit to conduct it alone.[5]

[1] Finance Co. of Pennsylvania *v.* Charleston, C. & R. Co. (1891), 45 Fed. Rep. 436. In Meier *v.* Kansas Pac. Ry. (1878), 5 Dill. 476, 479, Mr. Justice Miller made the following remarks as to the selection of receivers: "A receiver is strictly and solely the officer of the court. By reason of the inability or neglect of the officers of the corporation to conduct its business as it ought to be done, the conduct of that business is taken charge of by the court and carried on by its agent. It is the duty of that agent so to conduct the business as that the lawful rights and legal interests of all persons in the property and in the business shall be protected as far as possible with equal and exact justice. This is much more likely to be done by a receiver who has no interest in the capital stock of the road, nor in its debts, and no obligations to those who have. Such a person acting under the control of the court seeking its advice (as he would be inclined to do in all questions of doubtful duty), and bound in a sufficient surety for the faithful performance of his duty, is in my opinion the proper one for such an office." As to fitness and eligibility of one appointed a receiver, see People *ex rel.* Gore, etc. *v.* Illinois Building & Loan Assn. (1894), 56 Ill. App. 642. See "Who may be Receivers," note, 23 Am. L. Reg. N. S. 582, 589.

[2] State Trust Co. of New York *v.* National Land Imp. & Manufg. Co. *et al.* (1893), 72 Fed. Rep. 575; following Finance Co. *v.* Charleston, C. & C. R. Co. (1891), 45 Fed. Rep. 436. See also Phinizy *v.* Augusta & K. Ry. Co. (1893), 56 Fed. Rep. 273.

[3] Young *v.* Rollins (1881), 85 N. C. 485; s. c. 12 Am. & Eng. R. R. Cas. 455.

[4] Atkins *v.* Wabash, St. L. & Pac. R. Co. (1886), 29 Fed. Rep. 161, 174.

[5] High on Rec., § 72; McCullough *v.* Merchants' Loan & Trust Co. (1878), 29 N. J. Eq. 217. In Richards *v.* Chesapeake & Ohio R. Co. (1875), 1 Hughes, 28, the court denied a request to appoint the vice-president of the road, saying: "It appeared to the court then, as it does now, that the Chesapeake & Ohio R. Co. is overwhelmed with debt, secured and unsecured. How it came so is not for us to determine. But the court, when called upon to appoint a receiver for a corporation totally insolvent, who is to be the mere servant of the court, upon whose fidelity and ability to manage during the pendency of the suit the property intrusted to him the court must rely, ought not to be expected to appoint a person

To induce the court to appoint a former official of the road, it must in any case appear that the consent of at least the great majority of the creditors has been obtained.[1]

But even the consent of all the secured creditors has been deemed insufficient to warrant such an appointment.[2]

Nor will the assent of the creditors warrant the court in placing the business of the company in the hands of one of its former officials, unless his integrity is above suspicion, and it is shown that the disasters which have led to the foreclosure have not been due to his reckless management.[3]

Provided that the creditors give their assent, and there are no objections on the score of personal character, the court will give due weight to the consideration that the knowledge and familiarity of a particular person with the estate to be managed may justify a departure from the general rule.[4]

The case of a railway has even been thought to furnish an exceptionally strong illustration of the advisability of qualifying that rule, on the ground that the best interests of all parties may be promoted by the appointment of one who has been managing the business.[5]

under whose charge and control the resources of the road had been exhausted, its property seized upon execution, and the necessity of a receiver brought about."

[1] Farmers' Loan & Trust Co. *v.* Northern Pacific R. Co. (1894), 61 Fed. Rep. 546. In this case, a former president of the company was made receiver at the request, and on the nomination of, the trustees who represented by far the largest part of the bondholders, and with the consent of those bondholders themselves and of the company.

In Ralston *v.* Washington & C. C. R. Co. (1895), 65 Fed. Rep. 557, the court approved the nomination of a president of a railroad company as receiver by a trustee who had the power of selecting one under the provisions of the mortgage. There was said to be no inflexible rule on the subject.

In Fripp *v.* Bridgewater & Taunton Canal, etc. Co. (1853), 11 Hare, 241, 260, a customer, a shipper over the canal company, was held not a proper person for the receivership, as his double position would make a conflict between his duty and interest.

[2] Richards *v.* Chesapeake & Ohio R. Co. (1875), 1 Hughes, 28, Hughes, J., said: "The receiver is not the receiver of the bondholders or secured creditors. He is the mere hand of the court. The unsecured creditors, whose chances of a dividend are remote, have a deep interest in knowing that the road, while its assets are being marshalled, and its creditors, their claims and priorities, ascertained, is free from the control of those whose administration of its affairs ended in bankruptcy."

[3] Farmers' Loan & Trust Co. *v.* Northern Pacific R. Co. (1894), 61 Fed. Rep. 546.

[4] Sykes *v.* Hastings, 11 Ves. 363; Newport *v.* Bury, 23 Beav. 30.

[5] Farmers' Loan & Trust Co. *v.* Northern Pacific R. Co. (1894), 61 Fed. Rep. 546. There Judge Jenkins, in upholding the propriety of appointing a former president of the road to act as receiver, said: "Railway management has become a profession. A railway is not a toy that may be trifled with. Its management requires great financial and executive ability, and the practical experience of years. Railway management stands apart as a specialty. The ablest men in other professions

For reasons analogous to those which lead a court to select as receivers only such persons as are likely to represent impartially all those who are concerned in the issue of the suit, it is held that the attorney of the plaintiff should not be authorized to act as attorney for the receiver.[1]

A person is not disqualified for the position of receiver merely because he is not a railroad expert acquainted with all the details of the mechanical work of a railroad plant, provided he possesses integrity of character, business experience, a knowledge of affairs, a capacity for the examination into and comprehension of accounts, is not a partisan, and has no pecuniary interest in any one of the classes of creditors whose claims come before the court.[2]

From the fact that a receiver is an officer of the court by which he is appointed, it necessarily follows that he must be somebody living within the jurisdiction of the court,[3] though apparently the circumstance that he resides at a distance from the property to be administered is not an absolute disqualification.[4]

§ 517. **Necessity of Notice to Parties who will be affected by the Appointment.**[5] — In appointing a receiver a court of equity usually proceeds upon the fundamental principle that any person whose rights will be affected by judicial action ought to have an opportunity of presenting his side of the case. Thus the appointment of a receiver to take charge of corporate property will not be granted where the corporation itself is not a party to the bill, or in court in some other way, as on notice for a preliminary injunction.[6]

and in other walks of life would probably fail in the successful direction of the affairs of a railway, if they are wanting in that knowledge of its needs and requirements that may only be obtained by long experience in its practical management and operation. For the operation of a vast system like that of the Northern Pacific, it seemed desirable that one of its receivers should be a gentleman familiar with the intricate details of its history, and with the necessities peculiar to the system; for however well qualified one might be with respect to railway management in general, he would, at least, for a considerable time, be at sea in the management of a trans-continental line, of whose history he was ignorant, and with the necessities of which he was not familiar." The circumstances under which the order was issued are not stated, but, if the case is intended to rest on any assumed general principle that such an arrangement is warrantable, unless under a very exceptional showing of facts, it is evidently opposed to the weight of authority.

[1] Blair *v.* St. Louis, H. & K. R. Co. (1884), 20 Fed. Rep. 348. In this case it was also ruled that the receiver's attorney ought, in the absence of some special reason, to be a member of the bar of the circuit in which the receiver himself is appointed.

[2] Farmers' Loan & Trust Co. *v.* Cape Fear & Y. Valley R. Co. (1894), 62 Fed. Rep. 675.

[3] Meier *v.* Kansas Pacific R. Co. (1878), 5 Dill. 476.

[4] Wynne *v.* Lord Newborough, 15 Ves. 284.

[5] As to the removal of a receiver appointed *ex parte*, see § 547, *post*.

[6] Gravenstine's Appeal (1865), 49 Pa. St. 310.

Nor will a receiver be appointed to oust the possession of the purchaser at a previous execution sale of a railroad, where such purchaser has not been made a party to the proceedings.[1]

This rule, however, is subject to the exception that a receiver may be appointed upon an *ex parte* application, when it is shown that the delay which would result from giving notice would cause irreparable injury to the adverse party.[2]

Sufficient urgency to justify an *ex parte* appointment is not shown by a complaint which alleges the insolvency of the company and its predecessor, and levying of executions on the rolling-stock, the result being the stoppage of a traffic at a time when there are immense quantities of grain awaiting shipment. Such averments do not show that any great loss or damage is likely to occur during the brief period required for giving notice to a resident corporation.[3]

Nor ought an *ex parte* appointment to be made where the maladministration alleged as a ground for a receivership has already extended over several years, and it is evident that a brief delay will cause no substantial additional injury.[4]

The particular circumstances which constitute the necessity upon which the *ex parte* application is based must be set forth in the petition. A mere statement of the petitioner's opinion will not justify an appointment without notice.[5]

The fact that the defendant is out of the jurisdiction of the court is a sufficient reason for failing to give him notice of a motion for a receiver;[6] but the non-residence of the officers of a

[1] Searles *v.* Jacksonville, Pensacola, & Mobile R. Co. (1873), 2 Woods, 621.

[2] High on Rec., §§ 111, 113; Railway Co. *v.* Jewett (1882), 37 Ohio St. 649; 8 Am. & Eng. R. R. Cas. 702; State of Florida *v.* Jacksonville, Pensacola, & Mobile R. Co. (1875), 15 Fla. 201 (see p. 286); Ramsey *v.* Erie Ry. Co. (1869), 38 How. Pr. 193. See also Cooke *v.* Detroit & Milwaukee R. Co. (1881), 45 Mich. 453, and the note in the report of this case in 12 Am. & Eng. R. R. Cas. 459. There the Michigan court, in construing the statute of that State regarding corporations concluded that the management of the corporate business could be taken from a board of directors only in proceedings instituted to wind up the corporation in accordance with the provisions of that statute. For this reason it was held that a receiver ought not to have been appointed at the instance of a minority of the directors on an *ex parte* application, such an appointment being not merely irregular, but absolutely void, and an abuse of the power of the court, which might be corrected by *mandamus*. This ruling, however, is possibly not to be regarded as intended to deny the propriety of an *ex parte* appointment, in a very urgent case, at the instance of secured creditors.

[3] Chicago & S. E. Ry. Co. *v.* Cason (1892), 133 Ind. 49; s. c. 32 N. E. Rep. 827.

[4] Wabash Ry. Co. *v.* Dykeman (1892), 133 Ind. 56; s. c. 32 N. E. Rep. 823.

[5] Wabash Ry. Co. *v.* Dykeman (1892), 133 Ind. 56; s. c. 32 N. E. Rep. 823; High on Rec., § 113.

[6] Verplanck *v.* Mercantile Ins. Co. (1831), 2 Paige Ch. (N. Y.) 438 (per Walworth, Chancellor).

lessor company is no excuse for the omission to notify its lessee, which is in possession, and which is alleged by its maladministration to have brought about the condition of affairs which is the *gravamen* of the application.[1]

A corporation which is defunct, owing to the transfer of its powers and property to a new corporation, by virtue of legislative enactment, cannot, of course, be made a party to a suit; but this will not justify the court in appointing a receiver of its assets on an *ex parte* application. Such a receiver can be appointed only in a proceeding to which the successor of the extinct corporation or a substitute is a party.[2]

§ 518. **The Court will not go into the Merits of the Case upon the Hearing of an Application** for the appointment of a receiver.[3]

Hence a receiver will not be appointed on the preliminary hearing, where the propriety of the appointment is a principal question in the case, and it is required, if at all, by the view which the court shall ultimately take of the case, as part of the means which should be used to afford the relief contemplated by the decree.[4]

So also, upon the general principle that one who is lawfully and by the contract of the parties in possession of property should not be disturbed in that possession except in a clear case, a receiver will not ordinarily be appointed in a foreclosure suit, unless the right to foreclose is clear and indisputable. The appointment will be refused if there is a reasonable doubt as to whether the conditions of the mortgage have been broken.[5]

So also the court should hesitate before making an appointment on the ground of a possible injury to one holding nothing more than a disputed equitable claim for deferred stock.[6]

But the applicant need not show conclusively that he is entitled to recover in order to obtain the appointment of a receiver. He is only required to show a probable right.[7]

And if a bondholder is seeking to enforce a mortgage which on its face is susceptible of enforcement, the probable right thus indicated cannot be affected by an allegation on the part of the defendant that the securities are fraudulent and void. This prob-

[1] Wabash Ry. Co. *v.* Dykeman (1892), 133 Ind. 56; s. c. 32 N. E. Rep. 823.

[2] Young *v.* Rollins (1881), 85 N. C. 485; s. c. 12 Am. & Eng. R. R. Cas. 455.

[3] Kerr on Rec., p. 8.

[4] Union Mut. Life Ins. Co. *v.* Union Mills Plaster Co. (1889), 37 Fed. Rep. 286.

[5] American Loan & Trust Co. *v.* Toledo, C. & S. R. Co. (1886), 29 Fed. Rep. 416, 420.

[6] Overton *v.* Memphis & Little Rock R. Co. (1882), 10 Fed. Rep. 866.

[7] Des Moines Gas Co. *v.* West (1876), 44 Iowa, 23, where the court said that the rule was not changed by the Code of Iowa, which rather strengthened than impaired the rights.

ability, so far as regards the appointment of the receiver, will continue until the defence is made good. If the circumstances of the case show the advisability of appointing a receiver to take charge of the property pending the litigation, the court will not be prevented by such an allegation from making the appointment, and the determination of the issue of fact thus raised will be reserved for the final hearing.[1]

The court will sometimes postpone the final determination of an application for a receiver, so that the defendant may have time to take the necessary steps to make his defence good. Under such circumstances, he must act with reasonable promptitude. Any laches in this respect will warrant the court in dealing with the case, as if no defence had been put forward. Thus where the defence made to a petition by a judgment creditor for the appointment of a receiver is that the judgment was obtained by the collusion and fraud of the officers, the failure of the defendant to avail himself of an opportunity, granted him by a suspension of the proceedings, to apply to the court in which the judgment was recovered, and have it set aside, authorizes the inference that the defence is without merit, and justifies the court in proceeding with the case and appointing the receiver.[2]

§ 519. **A Full and Fair Denial by the Defendant of the Allegations in the Bill will preclude the Petitioner from obtaining a Receiver.** — To appoint one in the face of such denial is judicial error;[3] unless there is other evidence besides the sworn pleadings to support the application, in which case the court may consider whether that evidence does not overcome the denials in the answer.

§ 520. **When the Mortgagor Company may obtain the Appointment of a Receiver.** — Should the preponderance of evidence appear to be in favor of the complainant, a receiver may be appointed, notwithstanding the denials in the answer.[4]

§ 521. **At whose Instance a Receiver may be appointed, generally.** — In the great majority of the cases of the class with which the present treatise deals, the application for a receiver is naturally

[1] Keep *v.* Michigan R. Co. (U. S. C. Ct. 1873), 6 Chicago Legal News, 101, followed in Heinsheimer *v.* Dayton R. Co. 3 Ry. & Corp. L. J. 268 (Ohio Com. Pl. 1888); Farmers' Loan & Trust Co. *v.* Kansas City, W. & N. W. R. Co. (1892), 53 Fed. Rep. 182. In Owen *v.* Homan, 4 H. L. Rep. 997, it was said that the probability of the plaintiffs being ultimately entitled to a decree is one of the most material of the circumstances by which a court is guarded in dealing with applications for receivers.

[2] Loder *v.* New York, Utica, & Ogdensburgh R. Co. (1875), 4 Hun, 22.

[3] High on Rec., § 24.

[4] Allen *v.* Dallas & Wichita R. Co. (1878), 3 Woods, 316, 332; s. c. 1 Fed. Cas. 465, Case No. 221.

made by the secured creditors, and in one case it was even contended that, until the bondholders or their trustees are made parties to such an application, the court has no jurisdiction to appoint a receiver at the instance of the stockholders and general creditors of a railroad company whose property is under mortgage. This theory was, however, negatived, the question whether the protection and preservation of the property required the appointment being, it was said, necessarily addressed to the discretion of the court.[1]

§ 522. **When the Mortgagor Company may obtain the Appointment of a Receiver.** — The general rule is that a corporation cannot apply, in its corporate name and capacity, to be put into the hands of a receiver.[2]

But a railroad company itself has been allowed in one noteworthy suit to come into court, shortly before default, and obtain the appointment of a receiver over its property.[3] The appoint-

[1] Hervey *v.* Illinois Midl. Ry. Co. (1884), 28 Fed. Rep. 169, 176.

[2] Kimball *v.* Goodburn (1875), 32 Mich. 10.

[3] Wabash, St. Louis, & Pac. Ry. Co. *v.* Central Trust Co. (1884), 22 Fed. Rep. 272; 23 Fed. Rep. 513. On this proceeding and the criticisms levelled at it Judge Brewer made the following comments: "It may be it is not a common action, and yet I believe it is not solitary, nor the first. The application presented this state of facts to the court: that here was a vast property running through several States, burdened with a variety of local incumbrances and obligations whose value consisted largely in its being preserved in its entirety and with all its connections. Split up into a hundred fragments, the aggregate value of the varied fragments, it was contended, would be as nothing compared with the value of the single intact property; and the question was put before the court whether, two days before the default, when various rights of attack would arise in different parts of this territory, the court might anticipate and take possession of the property and preserve it intact, in order to permit the general mortgagee, when default actually occurred, to file its bill for foreclosure, and have the property as an entirety sold. While, of course, there were matters in respect to this, of doubt, that required consideration, yet both of us then thought, and both agree now, that it was wise that it was so done, and that the court properly appointed the receivers."

The mortgagee in this case filed a cross-bill in the suit in which the receiver was appointed, and it was held that this gave the court jurisdiction to proceed to foreclose the mortgage. A second suit, which was also commenced in the State court by the same mortgagee, was removed by the mortgagor company to the federal court, and on its motion consolidated with the former suit. Judge Brewer considered that, for the purpose of putting the question of jurisdiction beyond all doubt, it was not unwise to institute the second suit; but that, after the removal of that suit, the identity of the two suits in all respects indicated the propriety of consolidating them and proceeding with them as a single case.

Judge Brewer did not cite any authorities for the "unusual" course he took, but the principle of the case is countenanced to some extent by Macon & Western R. Co. *v.* Parker (1851), 9 Ga. 377, where it was held that equity would, at the instance of an insolvent company, take control of its road, when threatened by numerous *fi. fas.*, and in danger of being sold in sections, and have the property sold for the benefit of all parties. In this case there was apparently no formal appointment of a receiver, but the control of the court must have been exercised through what was virtually a receivership.

ment of a receiver at the instance of the corporation in this case was characterized by another circuit judge as "unusual and novel, to say the least,"[1] and the Supreme Court of the United States has also designated the bill filed by the company as "one of an unusual character."[2] But apparently the action of the court has not been *judicially* condemned in positive terms, except in one case.[3]

§ 523. **Receiver not usually appointed on Petition of General Creditors.** — General creditors cannot obtain the appointment of a receiver of a corporation except upon an allegation of fraud or breach of trust. Such relief will not be granted to them upon the ground that the corporation contemplates entering into an improvident contract, as where the bill states that it is insolvent; that all its property is mortgaged to trustees for the benefit of one class of creditors; that it owes large amounts to other creditors, one of whom has attached all its property; that it is about to execute a lease to the attaching creditor for a long term of years, at a rental which would not pay its indebtedness; and that the execution of the lease will be injurious to the interest of its creditors and stockholders.[4]

Nor ought a receiver to be appointed at the instance of general

[1] Atkins *v.* Wabash, St. L. & Pac. Ry. Co. (1886), 29 Fed. Rep. 161, per Judge Gresham. The question actually presented in this case, however, was merely the propriety of removing the receiver for malversation in office (see below).

[2] United States Trust Co. *v.* Wabash Western Ry. Co. (1893), 150 U. S. 287; s. c. 14 Sup. Ct. Rep. 86.

[3] In McIlhenny *v.* Binz (1890), 80 Tex. 1; s. c. 13 S. W. Rep. 655, a receiver was appointed in a suit instituted by the company itself, the bill alleging its insolvency, and praying that its property might be sold, and its proceeds distributed. The court referred with disapproval to the appointment in the Wabash case, but, as a mortgage creditor had afterwards filed a cross-bill for foreclosure, and the question was merely as to the validity of the subsequent proceedings, which were not objected to by those having the right to do so, there was no reversal of the action of the lower tribunal. Yet the court seems to be of opinion that the directors might properly have obtained the appointment of a receiver. This distinction between the corporation itself and its directors is not very intelligible, as the action of the corporation, under such circumstances, must necessarily be taken through the directors as its agents, and the directors could only be regarded as the official representatives of the corporation in regard to any action they might take in the premises. Whatever reasons exist against allowing the corporation itself to obtain the appointment of the receiver, must be equally valid against granting such relief to the directors.

[4] Pond *v.* Framingham & Lowell R. Co. (1881), 130 Mass. 194; s. c. 9 Am. & Eng. R. R. Cas. 551. In Lehigh Coal & Navigation Co. *v.* Central Railroad of New Jersey (1887), 43 Hun, 546, a similar decision was made, but the decision was based upon a statute by which the power of appointment was limited, and in which creditors at large were not mentioned. In both these cases it was said that the proper way for a creditor to obtain a standing in court to ask for a receiver was by reducing his claim to judgment and thus becoming a lienholder.

creditors merely in order to prevent a public sale of the property of the corporation to satisfy its bonds, where the petition is based upon unsupported allegations of a fraudulent design on the part of the directors to transfer the property to the bondholders for an inadequate sum, and there is no proof that the directors are wasting or destroying the property.[1]

§ 524. **Successive Applications for Receivers in the same Court, how treated.** — As a general rule of convenience, the court should not, in a subsequent suit, displace a receiver appointed by itself in a prior suit, affecting the same subject-matter. The proper course is to extend the receivership in the first suit over the second. Thus where a road has been placed in the hands of a receiver on the application of a junior mortgagee, and the senior mortgagee afterwards asks for a receiver, the original appointment may be extended to cover the second application.[2] But if a second receiver is appointed in the subsequent suit by an order purporting to displace the first receiver, such displacement is not void, for the reason that the order was not made in the suit in which the first receiver was appointed.[3]

A receiver appointed at the instance of the bondholders secured by a mortgage on an entire system is regarded as the custodian

[1] Fort Payne Furnace Co. *v.* Fort Payne Coal & Iron Co. (1892), 96 Ala. 472; s. c. 11 So. Rep. 439.

[2] Taylor *v.* Phil. & Reading R. Co. (1880), 7 Fed. Rep. 377; s. c. 14 Phil. 451. An official liquidator appointed under the English Companies Act is practically in the position of a receiver, and, according to the settled practice of the courts of equity, when a suit is brought to foreclose a lien on the property in liquidation, and the lienors petition for a receiver, the liquidator is appointed receiver. *In re* Henry Pound, etc., L. R. 42 Ch. Div. 402; 28 Am. & Eng. Corp. Cas. 500, per Kay, J., citing Perry *v.* Oriental Hotels Co., L. R. 5 Ch. 420, where the Court of Appeals made such an appointment on the application of an equitable mortgagee. But if debentures give the holders the right to appoint a receiver, with a power of sale, upon the continuance of a default for a specified time, the court will order the official liquidator to surrender possession of the property to the receiver so appointed, such order to be without prejudice as to any question which may afterwards be raised as to the powers of the receiver other than the power to take possession and to sell it. The Court of Appeals distinguished such a case from the more ordinary one in which a receiver is asked for in a suit to foreclose debentures not empowering the holders to appoint one for themselves, and in which the court exercises its discretion as to whom it shall appoint. The only reason why an application is necessarily made to the court, where the lienors thus reserve the right to appoint their receiver, is that the liquidator cannot otherwise be dispossessed. *In re* Henry Pound, etc., L. R. 42 Ch. Div. 402; 28 Am. & Eng. Corp. Cas. 500 (1890).

Debenture-holders have rights with which a winding-up ought not to be allowed to interfere, and when they have properly obtained the appointment of a receiver, the court will not allow him to be removed and the official liquidator put in his place. Strong *v.* Carlyle Press (1893), 1 Ch. 268; *In re* Joshua Stubbs (1891), L. R. 1 Ch. 475.

[3] State of Florida *v.* Jacksonville, P. & M. R. Co. (1875), 15 Fla. 201, 276.

of the interests of the divisional mortgagees also, and the latter cannot, as a rule, obtain the appointment of separate receivers. Such an appointment would have the effect of disintegrating the system and do much harm to all parties.[1]

For similar reasons the appointment of a separate receiver for a distinct part of a street-railway system will not be granted, unless some special reason is shown to exist for thus dividing the administration of the property. The court pointed out that the property was not large, that the services of another receiver were not necessary, and that the appointment would increase expenses, and complicate the situation by creating two administrations, which might eventually become hostile. It was, however, intimated that if the branch road were running, which was not the case, the receiver might perhaps have been directed to keep a separate account of its receipts and disbursements.[2]

On the other hand it has been laid down that, on the application of divisional mortgagees, a receiver appointed in a suit to foreclose a general mortgage junior to their own will at any time be divested of his control of the division, provided they will pay their proportion of the charges of administration which have been made a lien upon the property prior to all the mortgages.[3]

A stockholder who has brought suit against the corporation, asking to have a receiver appointed, cannot by intervening in a subsequent suit brought by the bondholders, asking a foreclosure and the appointment of a receiver, have the latter suit stayed until his own is determined, unless the case is an extraordinary one. Whether the stay shall be granted rests in a sound judicial discretion.[4]

The Minnesota statutes provide for the appointment of a receiver under certain circumstances to sequestrate all the corporate property for the benefit of the creditors, and it has been held that, as the powers of such a receiver are entirely different from those of a receiver appointed in a foreclosure suit, the fact that a receiver of the latter sort has been appointed is not a reason why a statutory receiver should not also be appointed.[5]

1 Wabash, St. Louis, & Pac. Ry. Co. *v.* Central Trust Co. (1884), 22 Fed. Rep. 272; Central Trust Co. *v.* Wabash, St. Louis, & Pac. Ry. Co. (1885), 23 Fed. Rep. 863, 868; Central Trust Co. *v.* Wabash, St. Louis, & Pac. Ry. Co. (1885), 25 Fed. Rep. 693.

2 Clap *v.* Interstate Street Ry. Co. (1894), 61 Fed. Rep. 537.

3 Central Trust Co. *v.* Wabash, St. Louis, & Pac. Ry. Co. (1886), 29 Fed. Rep. 616.

4 Pennsylvania Co. for Ins. on Lives and for Granting Annuities *v.* Jacksonville, T. & K. W. Ry. Co. (1893), 55 Fed. Rep. 131.

5 St. Louis Car Co. *v.* Stillwater Street Ry. Co. (1893), 53 Minn. 129; s. c. 54 N. W. Rep. 1064.

§ 525. **Appointment of Additional Receivers in other States or Districts.** — Receivers have frequently been appointed in English cases to take control of property or assets in other jurisdictions; but this can be done only when the parties interested in the property are personally before the court, and subject to its orders.[1] Receivers appointed in one jurisdiction are not entitled, as of right, to recognition in other jurisdictions; the rule being the same whether they are appointed under the ordinary practice of a court of chancery, or under a statute, like that of New York, which defines their authority. They have no extra-territorial power of official action; none which the court appointing them can confer, with authority to enable them to go into a foreign jurisdiction to take possession of the debtor's property; none which can give them, upon the principle of comity, a privilege to sue in a foreign court or another jurisdiction.[2]

Usually, however, the appointment of a receiver to take charge of a railroad running into other States of federal districts will be recognized, as a matter of comity, to the extent that he will be reappointed in the other jurisdictions.[3]

The reasons for refusing to embarrass the management of the system by appointing a separate receiver are of course stronger, where by far the largest and most important portion of the property is situated in the State or district where the first appointment was made.[4]

It has been held that an ancillary receiver will not be appointed upon a bill not filed for a final decree of foreclosure in the circuit in which it is filed, but simply for the purpose of having the court approve or confirm the appointment of a receiver already appointed in another circuit, and for the purpose of such other orders as might be necessary to vest in him the possession and control of any of the mortgaged property which might be in the circuit in which it was sought to have him appointed as receiver.[5] But in other districts than the one where this ruling was made, such bills have been frequently entertained, and the appointment generally, if not always, made in *ex parte* proceedings.[6]

[1] High on Rec., § 44.

[2] Booth *v.* Clark (1854), 17 How. 322.

[3] See, for example, Atkins *v.* Wabash, St. L. & Pac. Ry. Co. (1886), 29 Fed. Rep. 161.

[4] Port Royal & Augusta Ry. Co. *v.* King (1893), 93 Ga. 63; s. c. 19 S. E. Rep. 809.

[5] Mercantile Trust Co. *v.* Kanawha & Ohio Ry. Co. (1889), 39 Fed. Rep. 337.

[6] See the remarks of the court in Platt *v.* Philadelphia & Reading R. Co. (1893), 54 Fed. Rep. 569, where an ancillary receiver was appointed, but without prejudice to a full consideration of the legality of the practice, in case a motion should subsequently be made to annul the order.

ARTICLE II. — CIRCUMSTANCES UNDER WHICH A RECEIVER WILL OR WILL NOT BE APPOINTED.

§ 526. **General Principles upon which Receivers are appointed.**[1] — Whether a receiver shall or shall not be appointed in a given case is always said to be a matter resting in the discretion of the court.[2] This principle was held to warrant a court in ruling that, even if the inadequacy of the legal remedy is demonstrated, and the case is such as would ordinarily lead as a matter of course to the appointment of a receiver, no receiver will be appointed where, upon a survey of all the circumstances, it is apparent that there are special considerations of propriety or convenience which render the appointment, on the whole, an inexpedient remedy. By the "Florida Improvement Act" certain public lands were vested in the Governor and other State officials, as trustees, to constitute an "Internal Improvement Fund," and to serve, among other things, as a guaranty of bonds to be issued by certain designated railroad companies. The interest on the bonds of one of those companies being in default, the trustees seized and sold the road, and with the proceeds of the sale purchased and cancelled a large part of the outstanding guarantied bonds. A holder of some of the bonds not thus purchased filed a bill for relief against the trustees, whom he charged with mismanaging the funds, and asked for the appointment of a receiver. This petition was denied by Mr. Justice Bradley, who explained his reasons as follows: "In this case the trustees having possession of the trust fund and property are public officers and trustees *ex officio*. . . . The State has a great interest in the trust. It is not merely to preserve the fund as a security for the payment of the railroad bonds that the trust is created, but to provide for the drainage and reclamation of the lands, and their settlement and cultivation. These are political objects of the most important character. . . . These public and political objects of the trust make it extremely fitting that the chief executive officers of the State should administer the fund. And it must be a very strong case

[1] For a collection of authorities and a discussion of the subject of the appointment of receivers, see Woods Ry. Law, 1648–1652; Rorer on Railroads, 889, 994; and the notes in 12 Am. & Eng. R. R. Cas. 461, and 30 Am. & Eng. R. R. Cas. 158.

[2] Sage *v.* Memphis & Little Rock R. Co. (1888), 125 U. S. 361; Tysen *v.* Wabash Ry. Co. (1878), 8 Biss. 247; Farmers' Loan & Trust Co. *v.* Kansas, W. & N. W. R. Co. (1892), 53 Fed. Rep. 182; Vose *v.* Reed (1871), 1 Woods, 647, 650; Williamson *v.* New Albany, etc. R. Co. (1857), 1 Biss. 198, 205; Hervey *v.* Illinois Midland R. Co. (1884), 28 Fed. Rep. 169; Douglass *v.* Cline (1877), 12 Bush (Ky.), 608; s. c. 18 Am. Ry. Rep. 273; High on Rec., § 7; Kerr on Rec., p. 3; Beach on Rec., § 5.

indeed which will induce the court to take the property out of their hands and put it into the hands of its own officers. The legislature has seen fit to intrust the chief officers of the State with these important duties, and it would show a great disrespect to this co-ordinate branch of the government for the judiciary, on light grounds, to displace these officers from the trust, and to put appointees of its own in their stead." It was then pointed out that, if the trustees should be guilty of a breach of duty, they could be enjoined; that they were personally responsible; and that the fund could be followed into the hands of persons getting hold of it in a fraudulent manner. The inconvenience of withholding the property from each new set of officers, as they might be elected from time to time, was also dwelt upon, as well as the peculiar and important duties attaching to the trust, which, if undertaken by the court through a receiver, would necessitate taking cognizance of the requirements of a vast political territory in reference to drainage, development, pre-emption, and population. On the whole, therefore, the learned justice considered it to be a case in which, if a receiver could be appointed at all, the appointment ought not to be made until every other remedy had been tried in vain.[1]

The court will also exercise its discretion to refuse a petition for a receiver where there is good ground for the conclusion that the business in and of which the complainant asks this relief is not legitimate. Thus it has been held in a recent case that, whether the question arises or not in a jurisdiction where a statute has been enacted for the suppression of monopolies, a contract for the prevention of a healthy competition in some particular trade is one which should not be favored by a court of equity, and that its enforcement will not be aided by the appointment of a receiver.[2]

§ 527. **Limits to the Discretionary Powers of Courts in appointing Receivers.** — Except in cases like those referred to in the preceding section, the freedom of judicial action is practically circumscribed by well-recognized subsidiary principles which have imparted a considerable degree of precision to an extremely vague and shadowy rule, and have in practice left the hypothetical discretion of the court little more than a name. These principles we shall now proceed to examine by the light of the authorities in the following sections of the present subdivision.

[1] Vose *v.* Reed *et al.*, Trustees (1871), 1 Woods, 647.

[2] American Biscuit Mfg. Co. *v.* Klotz (1891), 44 Fed. Rep. 721; 9 Ry. & Corp. L. J. 316.

§ 528. **The Appointment of a Receiver is not justifiable** merely because it will furnish a more agreeable and convenient way of protecting the rights of the suitor;[1] or on the abstract ground that the appointment will do good;[2] or will do harm.[3]

A fortiori is it contrary to equitable principles to appoint a receiver, if some of the other parties in interest would thereby suffer injustice;[4] or if, upon a review of all the circumstances, greater injury than good will result from the appointment.[5]

§ 529. **No Receiver appointed unless Appointment will give Effectual Relief.** — As equity does nothing in vain, the appointment of a receiver will be refused, unless it will probably result in effectual relief. Thus a receiver will not be appointed at the instance of a judgment creditor to enable him to obtain his share of the earnings of a canal, where those earnings have by statute been made applicable, and are being applied by the lessee of the canal towards the reduction of the incumbrances, and are sufficient to pay the interest thereon.[6] Nor will a court appoint a receiver of rents and profits where there is no property coming under that description which he can administer upon.[7]

[1] Overton *v.* Memphis & Little Rock R. Co. (1882), 10 Fed. Rep. 866.

[2] Vermont & Canada R. Co. *v.* Vermont Central R. Co. (1877), 50 Vt. 500; s. c. 14 Am. Ry. Rep. 497.

[3] Orphan Asylum Soc. *v.* McCartee *et al.* (1825), 1 Hopk. Ch. (N. Y.) 500; Blondheim *v.* Moore (1857), 11 Md. 365; Smith *v.* Port Dover R. Co. (1885), 12 Ont. App. 288; s. c. 25 Am. & Eng. R. R. Cas. 639, citing the two first-mentioned cases. Vermont & Canada R. Co. *v.* Vermont Central R. Co. (1877), 50 Vt. 500; s. c. 14 Am. Ry. Rep. 497.

[4] Fosdick *v.* Schall (1878), 99 U. S. 235, 253.

[5] Vose *v.* Reed (1871), 1 Woods, 647, 650, followed in Tysen *v.* Wabash Ry. Co. (1878), 8 Biss. 247, 256. In the latter case the court declined to appoint a receiver, at the instance of a small minority of the bondholders, where a funding scheme had been agreed upon by an overwhelming majority of such bondholders, and the arrangement for the operation of the road adopted as a part of the scheme was on the whole successful. The appointment, it was pointed out, would not only break up the system into its original fragments, but also overturn the funding scheme, thus destroying a large present income for a great majority of the bondholders. Besides this, there was the objection that it would work the financial ruin of all the interests subordinate to the first mortgage. "If," said Mr. Justice Harlan, "the present management of the road were guilty of any fraud or dishonest practices in their control of this property, I should feel differently. While there are differences between them and some of the bondholders as to certain matters connected with the discharge of the company's obligations, those differences do not involve the integrity of those operating the railroad. The court is disposed to recognize the absolute necessity of large discretion in the management of such vast property, and in the distribution of the net income arising therefrom, and it is unwilling, for the present at least, to make honest differences as to such matters the basis for its interference by the appointment of a receiver."

[6] Stewart *v.* Chesapeake & Ohio Canal Co. (1881), 5 Fed. Rep. 149.

[7] Mercantile, etc. T. Co. *v.* River Place, etc. Co. (1892), L. R. 2 Ch. 303.

§ 530. **The Existence or Non-existence of Danger to the Fund** or property on which the petitioner relies for payment has been said to supply the proper test for determining whether a receiver should be appointed or not.[1]

§ 531. **Adequacy of Legal Remedy a Reason for refusing to appoint Receiver.** — The rule mentioned in the preceding section must, it is scarcely necessary to point out, be applied with due reference to the universal principle underlying all equitable relief, viz., that the legal remedy is inadequate. The court will not exercise this extraordinary power of appointing a receiver where the loss or danger, such as it is, may be averted by legal proceedings.[2]

Thus the application of a bondholder for a receiver, in a suit in which he seeks to set aside a reorganization agreement, will be denied, where no irreparable injury is threatened, and the defendant is solvent and capable of responding in damages.[3]

Nor will a receiver be appointed to take possession of a railroad during litigation because of alleged failure of the operators to keep it in suitable repair, where the operating company is financially responsible, and acknowledges its duty and is compellable by law to keep the road in repair.[4]

§ 532. **Default of Mortgagor alone not sufficient to justify Appointment.** — Frequent illustrations of the principle stated in the last section but one are furnished by the cases in which the courts have acted upon the rule that this extraordinary relief will not be granted merely on the ground that the defendant is in default. Such default may or may not be an occasion for appointing a receiver.[5]

[1] State *v.* Northern Central R. Co. (1861), 18 Md. 193. This principle has been embodied in the statutes of several States which provide for the appointment of a receiver whenever the property is "in danger of being lost, removed, or materially injured." Civil Code of Kentucky, § 329 (see Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush (Ky.), 673); Ohio Rev. Stat., § 5587 (see Hensheimer *v.* Dayton R. Co., 3 Ry. & Corp. L. J. 268); Ohio Code, § 254. (See State Journal Company *v.* Commonwealth Company (1890), 43 Kans. 93; s. c. 22 Pac. Rep. 982; 28 Am. & Eng. Corp. Cas. 443.)

[2] Overton *v.* Memphis & Little Rock R. Co. (1882), 10 Fed. Rep. 866.

[3] Matthews *v.* Murchison (1883), 15 Fed. Rep. 691.

[4] Boston, Concord, & Montreal Railroad *v.* Boston & Lowell Railroad (1891), 65 N. H. 393; s. c. 23 Atl. Rep. 529.

[5] Williamson *v.* New Albany, etc. R. Co. (1857), 1 Biss. 198; Farmers' Loan & Trust Co. *v.* Chicago & A. Ry. Co. (1886), 27 Fed. Rep. 146; American Loan & Trust Co. *v.* Toledo, C. & G. R. Co. (1886), 29 Fed. Rep. 416, 420. In Mercantile Trust Co. *v.* Missouri, K. & T. Ry. Co. (1888), 36 Fed. Rep. 221; s. c. 4 Ry. & Corp. L. J. 362, Judge Brewer thus stated the general principle in regard to the effect of a default, quoting from the report as it appears in 4 Ry. & Corp. L. J. 363, 364: "The mere fact of a default in payment of interest does not give the party the right to come into a court of equity and have a receiver. Something beyond that must exist. It is difficult to formulate any law which, briefly stated,

In the absence of circumstances which imperil the security, corporate officers to whom no fraud or incompetency is imputed are obviously, by reason of their familiarity with the details of the business, more likely than a stranger to manage the property to the best advantage, and should not be displaced merely because a foreclosure suit has been instituted.[1]

In no case, therefore, ought a receiver to be appointed if it is apparent that the property is sufficiently valuable to be an adequate security for the payment of the petitioners' claim.[2]

Still less, of course, will a receiver be appointed on the mere ground of a default, if it appear that the company may excuse such default, or that the plaintiff may be estopped from relying on it.[3]

But the continuance of a default for ten years is not excused by the plea that several millions of dollars have been spent by the company in perfecting its connections with a view to obtain a line to a commercial centre. Whatever is done for such a purpose is done at the company's own risk; and if, by assuming

will control in all cases. But if it appear that there is some danger to the property, that its protection, its preservation, or the interests of the various owners require possession by the court, then a receiver should be appointed. It does not go as a matter of course, and yet it is a matter that a court cannot refuse simply because it is an annoyance." For very similar language see Union Trust Co. *v.* St. Louis, Iron Mountain, & Southern R. Co. (1877), 4 Dill. 114, where it was said that, in addition to a default, the petitioner must also show that the beneficiaries under the mortgage will also suffer loss, if the property is allowed to remain in the hands of the company until the final decree. As to the more special question involved in this case, see below, in this chapter.

[1] Meyer *v.* Johnston (1875), 33 Ala. 237; s. c. 15 Am. Ry. Rep. 467; Blair *v.* St. Louis, H. & K. R. Co. (1884), 20 Fed. Rep. 348.

[2] Pullan *v.* Cincinnati & Chicago Air Line R. Co. (1865), 4 Biss. 35, 49 (in this case a receiver was appointed, default having continued, without a valid excuse, for ten years, while the probable proceeds of a foreclosure sale were not sufficient to satisfy the debt); Milwaukee *v.* Soutter, 2 Wall. 510, 523 (in this case a receiver was refused, the amount in suit being small compared with the value of the property). The inadequacy of the security is usually recognized as a statutory ground for the appointment of a receiver wherever the subject has been regulated by the legislature. See, for example, the enactments in Kentucky and Ohio, construed in the cases cited in the note above. But in New Jersey the general rule has been modified for special reasons of public policy in the direction of greater severity. A company is there insolvent "within the meaning of a statute which provides that a receiver may be appointed in case of insolvency or suspension of its business, when its entire capital stock and an additional sum besides has been expended in building and equipping the road, and an indebtedness for current expenses incurred and still unpaid, even though that indebtedness be comparatively small, and the value of the whole property is sufficient to leave a surplus, if it was sold and the affairs of the company wound up. Sewell *v.* Cape May R. Co. (N. J. Eq., 1887), 30 Am. & Eng. R. R. Cas. 155.

[3] American Loan & Trust Co. *v.* Toledo C. & S. Ry. Co. (1886), 29 Fed. Rep. 416, 420.

burdens of this description, it becomes the less able to pay the interest on its bonds, this fact furnishes a reason for the appointment of a receiver.[1]

§ 533. **Receivership usually denied if Default not complete.** — Since the right to obtain the appointment of a receiver in a foreclosure suit will usually depend on whether the right to foreclose is complete at the time the application is made, evidence that there is an agreement between the parties interested that money will be furnished for the payment of interest after default will, in the absence of some specific danger to the fund, justify the court in denying a receivership, inasmuch as a reasonable controversy is thereby raised as to whether there has been an extension of the time of payment.[2]

§ 534. **Prevention of Fraud.** — A receiver will be appointed for the purpose of preventing fraud and preserving the subject of litigation, where a company issues bonds redeemable according to their numbers, under a scheme which will result in great gains by forfeitures of other numbers.[3]

§ 535. **Prevention of Waste.** — It is well settled that a proper case for the appointment of a receivership is presented, when the mortgaged property is an insufficient security, and there is good ground to believe that it will be wasted or deteriorate in the hands of the mortgagor.[4]

But the mere disuse of a manufacturing plant, under an agreement with other manufacturers to restrict production, though attended with the decay and dilapidation inseparable from disuse, is not such destruction or waste as to entitle a mortgagee of the property to ask for a receiver.[5]

A fortiori will this relief be granted when the mortgagor is insolvent and without credit, and the property is already going

[1] Pullan *v.* Cincinnati & Chicago Air Line R. Co. (1865), 4 Biss. 35, 49.

[2] American Loan & Trust Co. *v.* Toledo C. & S. R. Co. (1886), 29 Fed. Rep. 416, 419.

[3] McLoughlin *v.* National Mut. Bond & Investment Co. (1894), 64 Fed. Rep. 908.

[4] Omaha Hotel Co. *v.* Kountze (1882), 107 U. S. 378; Vose *v.* Reed (1871), 1 Woods, 647, 650; White Water Valley Canal Co. *v.* Vallette (1858), 21 How. 414; High on Rec., § 4.

By the decree discussed in Davenport *v.* Receivers (1875), 2 Woods, 519, a receiver had been appointed in accordance with the agreement of the parties, and upon allegations that the property was deteriorating in value, and being wasted, scattered, and destroyed, whereby the security of the first-mortgage bondholders and the interest of all other persons then concerned in that property were subjected to danger, and upon a showing that it was impossible to dispose of the property in its then condition without great sacrifice.

[5] Union Mut. Life Ins. Co. *v.* Union Mills Plaster Co. (1889), 37 Fed. Rep. 286.

to utter waste, and the mortgagor unable to repair or use it so as to earn a revenue.[1]

An appointment on the ground of threatened waste may be made even before the maturity of the debt.[2]

§ 536. **A Long-continued and Hopeless Condition of Insolvency.** — This may sometimes operate as a sufficient reason for appointing a receiver, as where the company is in default for a large amount of interest, its income diminishing, its business threatened with a dangerous competition from the building of rival lines, and there is an apparent lack of harmony among the bondholders, who are virtually the owners of the road. An additional special feature was that by the law of the State in which the corporation was organized, the only way in which the mortgagee could get possession of the rents and profits was by the institution of a foreclosure suit and the appointment of a receiver. So where the finances of the company are at such a low ebb that it is incapable of even constructing a few miles of road, and the consequences of completion within a given time will be the loss of a valuable land-grant which forms a part of the security on which the bondholders rely, the court will appoint a receiver to take charge of the property and finish the work.[3]

To establish such a hopeless state of insolvency as will induce a court to grant a receiver, it has been held sufficient to show that the company has allowed the taxes on some of its property to go to default, and thus incurred the severe penalties attaching to such delinquency, and that it was largely in debt for wages and supplies, which, under the so-called "six-months rule," were entitled to preference over the mortgage lien, if they were not otherwise provided for, such an accumulation of preferential debts being a direct source of peril to the rights of bondholders.[4]

So also a receiver will be appointed at the instance of a mortgagee who has only a second lien on a part of the railroad, and a third and fourth on other parts which lie beyond the limits of the jurisdiction of the court, when the company's condition is such that, in order to prevent the ruin of its creditor, and the practical cessation of its business, it is forced to misapply its revenues.[5]

[1] Brown *v.* Chesapeake & Ohio Canal Co. (1891), 73 Md. 567.

[2] Long Dock Co. *v.* Mallery (1858), 12 N. J. Eq. 431; Brassey *v.* New York & N. E. R. Co., 22 Blatch. 72; s. c. 19 Fed. Rep. 663; Union Trust Co. *v.* Illinois Midland Ry. Co. (1885), 117 U. S. 434.

[3] Kennedy *v.* St. Paul & Pacific R. Co. (1873), 2 Dill. 448, 453; s. c. 14 Fed. Cas. 321, Case No. 7706; Allen *v.* Dallas & Wichita R. Co. (1878), 3 Woods, 316; s. c. 1 Fed. Cas. 465, Case No. 221.

[4] Putnam *v.* Jacksonville L. & St. L. Ry. Co. (1893), 61 Fed. Rep. 440.

[5] State *v.* Northern Central R. Co. (1861), 18 Md. 193.

There can be no question but that a company is insolvent when it has mortgaged all its property twice, and finally made an assignment of all its bills receivable and available assets to a syndicate of the directors to secure the payment of a loan to defray operating expenses.[1]

So also the appointment of a receiver is justified, when the company is practically insolvent, its affairs are in a chaotic condition, it has no president, vice-president, or treasurer, its trustees are about to resign, and there are no means of satisfying its outstanding obligations, which are about to be enforced against its plant and property.[2]

So a proper case for a receivership is presented when the current expenses have equalled the earnings ever since the road went into operation, and no interest has ever been paid.[3]

There are, of course, especially strong reasons for appointing a receiver as a relief when the impecuniosity of the company is so extreme as to affect the interests of the public by impairing its capacity to perform the duties of a carrier of freight and passengers. Thus a receiver has been appointed where the affairs of a company were in a state of hopeless embarrassment; the physical condition of the road such that it could not be operated with profit, nor without great danger to life and property; the rolling-stock insufficient for the business to be carried on; and the income not large enough to meet current expenses; the result being that the manager, in order to keep control of the employees, was forced periodically to borrow money on the pledge of his own personal credit and that of his friends.[4]

§ 537. **Dissensions among the Corporate Officers.** — A receiver may be appointed in a suit to foreclose a chattel mortgage where a corporation is greatly embarrassed by its debts, and there are dissensions among its officers likely to injure materially the value of its property.[5]

§ 538. **The Demonstrated Indisposition of an Insolvent Company to pay its Debts, even to the Extent of its Ability to do so.** — This will, of course, weigh strongly with the court in a case where there might otherwise be some doubt as to the advisability of an immediate appointment.[6]

[1] In the Matter of the South Carolina R. Co., 11 Chic. Leg. News, 8.

[2] Ralph *v.* Shiawassee Circuit Judge (1894), 100 Mich. 164; s. c. 58 N. W. Rep. 837.

[3] Benedict *v.* St. Joseph & W. R. Co. (1883), 19 Fed. Rep. 174.

[4] Heinsheimer *v.* Dayton, etc. R. Co. (Ohio Com. Pl., 1888), 3 Ry. & Corp. L. J. 268.

[5] State Journal Company *v.* Commonwealth Company (1890), 43 Kan. 93; s. c. 22 Pac. Rep. 982; 28 Am. & Eng. Corp. Cas. 443.

[6] Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 260, 263.

§ 539. **The Wrongful Failure of the Company to apply its Revenues to the Bonded Debt.** — This presents an appropriate case for the appointment of a receiver when its insolvency and the inadequacy of the security are also established.[1]

But no misapplication is shown where the revenues have been applied to the reduction of a floating debt incurred for the completion and equipment of the road, whereby the security of the bondholders has been improved and enlarged, especially if this has been done with the approval of the trustees and a large majority of the bondholders.[2]

A similar rule is applicable where the improper use of the revenues is being made by persons who have superseded the company in the control of the property by virtue of legal proceedings in which the bondholders have taken no part. Thus a receiver will be appointed where the company has been declared bankrupt and practically dissolved, the amount of its outstanding bonds, with the accumulations of interest thereon, exceeds the value of the property mortgaged to secure them, and the purchasers of the company's equity of redemption at the assignee's sale are in possession of the road, receiving the income to which the mortgagee is entitled, and using the road for their own exclusive use and benefit.[3]

§ 540. **The Danger to the Fund arising from Mismanagement of the Corporate Property** is a ground for appointing a receiver when a *prima facie* case of such mismanagement is made out.[4]

Such mismanagement may consist in an abuse of the corporate franchises,[5] or may arise from the business incapacity of the managers of the road, the result being that the property has changed hands several times.[6]

But the fact that the property of a company in which the State owns a large amount of stock has been used by the directors to further political schemes, and that they have made an extravagant

[1] Keep *v.* Michigan R. Co., 6 Chic. Leg. News, 101; Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 260.

[2] Williamson *v.* New Albany, etc. R. Co. (1857), 1 Biss. 198. Under the circumstances of this case it was ordered that the officers of the company set aside one-half of the net earnings of the road for the payment of the interest on the floating debt, and a full monthly report be made to the court, the complainant having the right to renew his application for a receiver upon a new statement of facts.

[3] Kelly *v.* Trustees (1877), 58 Ala. 489; s. c. 31 Am. Ry. Rep. 138.

[4] Stewart *v.* Chesapeake & Ohio Canal Co. (1881), 5 Fed. Rep. 149; Pullan *v.* Cincinnati & Chicago Air Line R. Co. (1865), 4 Biss. 35, 47; s. c. 20 Fed. Cas. 32, Case No. 11,461.

[5] City of Rochester *v.* Bronson (1871), 41 How. Pr. 78.

[6] Pullan *v.* Cincinnati & Chicago Air Line R. Co. (1865), 4 Biss. 35, 47; s. c. 20 Fed. Cas. 32, Case No. 11,461.

outlay for entertainments and personal expenses, does not justify the employment of the costly machinery of a receivership.[1]

An additional reason for the interference of a court of equity is presented when the mismanagement involves the element of fraud, as where the directors have executed a mortgage of the corporate property to themselves to secure their own claim. Under such circumstances the other creditors, in a suit brought to set aside the mortgage, may have a receiver appointed.[2]

So also a receiver is properly appointed where a stockholder, a bondholder, and the trustees bring suit in a representative capacity against the directors, charging them with squandering and embezzling the corporate property.[3]

Facts which create a reasonable certainty that the directors will abuse their fiduciary position to the detriment of the company will also justify a receivership, as where the majority of the railroad company's stock is owned by an improvement company, and the officers of the two corporations are substantially the same persons, the result being that the interests of the bondholders are placed at the mercy of persons whose interests may be quite antagonistic to their own.[4]

The fact that the mortgagee in possession is mismanaging the property is the only recognized ground on which a receiver will be appointed in a suit to redeem.[5]

§ 541. **Numerous Executions threatening Integrity of Property.** — It is well settled that equity will interfere to prevent a railroad from being sold piecemeal by execution creditors to the detriment of lienors, and will, at the instance of the latter, appoint a receiver, with a view of having the property sold as an entirety for the benefit of all parties in interest.[6]

So also upon a bill for an injunction against attacks on the mortgaged property by numerous attachments, where it is shown that the corporation is entirely insolvent; that it is unable to pay its secured debts, its floating debt, or the sums due to connecting lines, and unable to borrow money for that purpose; that it is in peril of the breaking up and destruction of its business; and that

[1] Stewart *v.* Chesapeake & Ohio Canal Co. (1881), 5 Fed. Rep. 149, 156.

[2] Haywood *v.* Lincoln Lumber Company (1885), 64 Wis. 639; s. c. 26 N. W. Rep. 184.

[3] Forbes *v.* Memphis, El Paso, & Pac. R. Co. (1872), 2 Woods, 323.

[4] Farmers' Loan & Trust Co. *v.* Winona, W. & S. W. Ry. Co. (1893), 59 Fed. Rep. 957.

[5] Boston & Providence R. Corp. *v.* New York & New England R. Corp. (1878), 12 R. I. 220.

[6] Sage *v.* Memphis & Little Rock R. Co. (1888), 125 U. S. 361; *In re* South Car. R. Co., 11 Chicago Leg. News, 8 (U. S. Cir. Ct., 1878); Edwards *v.* Standard Rolling-Stock Syndicate (1893), L. R. 1 Ch. 574.

a default on its securities is imminent and manifest, — a temporary receiver may properly and wisely be appointed to protect the property.[1]

The appointment of a receiver will be granted upon a bill filed by a stockholder of a consolidated corporation and judgment creditors, alleging that executions are being levied on the property; that it is being sold at a sacrifice; and that there is great difficulty in determining upon what property the different executions should be levied. Under such circumstances the court will take possession by a receiver, without regard to the question how far its action will affect the rights of parties not before it.[2]

§ 542. **Circumstances under which a Judgment Creditor will be granted a Receivership of Mortgaged Property.** — A bill filed by a judgment creditor of a railroad company which alleges in substance that the corporate property is so heavily mortgaged that if the plaintiff should attempt to enforce payment of his debt, by seizure and sale on execution, there would be no bidders except at a nominal amount, while if the property were placed in the hands of a receiver, and held together and carefully operated, there would be a large surplus each year for the payment of the plaintiffs, has been held to contain averments amply sufficient to give a court jurisdiction to appoint a receiver.[3]

§ 543. **Right to Receiver, when lost by Laches.** — The maxim, *vigilantibus non dormientibus equitas subvenit*, is as applicable to appointments of receivers as to other forms of equitable relief.[4]

Thus the failure to follow up a petition for the appointment of a receiver for six years will deprive the petitioner of his right to have such appointment made.[5]

So also, where the suit is one to set aside the reorganization of a new company by the bondholders who have purchased through a committee at the foreclosure sale, the petitioner cannot procure the appointment of a receiver over the property of that company if his acts during the progress of the negotiations which resulted in the purchase and reorganization were such as to lead the public and the committee to suppose that he acquiesced in what was done.[6]

[1] Brassey *v.* New York & New England R. Co. (1884), 19 Fed. Rep. 663, citing Long Dock Co. *v.* Mallery, 12 N. J. Eq. 431.

[2] Hervey *v.* Ill. Midland Ry. Co. (1884), 28 Fed. Rep. 169.

[3] Sage *v.* Memphis & Little Rock R. Co. (1888), 125 U. S. 361.

Under the English Companies Act of 1867, whenever a judgment creditor is unpaid, he may, as a matter of right, obtain the appointment of a receiver. *In re* Manchester, etc. Ry. Co., L. R. 14 Ch. Div. 645 (1879).

[4] High on Receivers, § 14.

[5] Hood *v.* First National Bank of Tremont (1886), 29 Fed. Rep. 55.

[6] Matthews *v.* Murchison (1883), 15 Fed. Rep. 691.

§ 544. **Effect of a Provision in Mortgage authorizing the Trustee to take Possession on Default.** — The right of the trustee to take possession after default has been viewed as furnishing a conclusive reason for denying an application for a receiver, on the ground that the legal remedy afforded by a stipulation conferring such a right is fully adequate to enable the trustee to protect the interests of his beneficiaries.[1]

The rule here laid down is very much the same as that of the English Court of Chancery, until it was altered by statute; viz., that a receiver ought not to be appointed in behalf of a mortgagee who had the legal estate, because he had nothing to do but to take possession.[2]

On the other hand it has been held that, where the trustees under a mortgage by which the income is pledged to the payment of the principal and interest of the bonds are empowered to take possession after the continuance of a default for a specified period, it is the clear duty of the court to appoint a receiver, irrespective of any showing that the property is insufficient to pay the mortgage debt, that the mortgagor is insolvent, that the trust property is in jeopardy, or the like.[3]

So also it has been held that where the trustees have neglected to take possession, a bondholder may, in a suit brought to compel them to perform their duty, obtain the appointment of a receiver,

[1] Rice *v.* St. Paul R. Co. (1878), 24 Minn. 464.

[2] Daniell's Ch. Pr. 1724, 1725.

[3] Allen *v.* Dallas & Wichita R. Co. (1878), 3 Woods, 316, per Woods, J. This case seems scarcely reconcilable with the principles upon which receivers are ordinarily appointed. Much stress was laid by the learned judge upon the supposed principle that the rights of railroad bondholders were not to be measured by the same rules as those which apply to a mortgage of a house or lot to secure one or two promissory notes. The correctness of the doctrine, that a mere default in the payment of interest was not a ground for the appointment of a receiver, was admitted, but it was declared not to be applicable where there is a stipulation that the mortgagee shall have the rents; the authorities cited being Whitehead *v.* Wooten (1870), 43 Miss. 523; Morrison *v.* Buckner (1843), 1 Hempstead, 442. But those cases merely refer to the general rule as to the action of a court of equity in sequestrating the income of an estate where the creditor is entitled to it, and has no way of enforcing his rights except by a creditor's bill. They are not an authority for the position that a court of equity will aid a mortgagee in this way, where he has, by an express stipulation in the mortgage, reserved a legal remedy such as the right of entry upon the default of the mortgagor.

There is doubtless a clear and well-defined distinction as to the right to have a receiver of the income appointed where the income is expressly pledged and where it is not: see Des Moines Gas Co. *v.* West (1876), 44 Iowa, 23; Jones on Mortgages, § 1516; but the real question in the case of a mortgage which gives the right of entry as regards the entire property is whether such a stipulation does not supply an adequate legal remedy, and thus do away with the necessity of equitable interference, except in so far as it may be required for the purpose of compelling the trustees to do their duty.

and that such appointment was not necessarily predicated on the apprehension that the debt would be lost.[1]

§ 545. **Last Subject continued.** — A like ruling has been made where the suit in which the appointment was made was one brought to obtain possession, the court expressly distinguishing between such a suit for specific performance and one for foreclosure, in which the power of appointment was limited by statute to certain specified cases.[2]

A doctrine intermediate between these two is, that the fact of the trustees having the power to take possession of the property in the event of a default does not constitute a sufficient reason for refusing to appoint a receiver. Such a power may be waived, if the mortgagees prefer to invoke the interposition of a court of chancery.[3]

The more reasonable view would certainly seem to be that the fact of the income's being subject to the mortgage cannot affect the general principle that a mere default is not sufficient to warrant the appointment of a receiver, even though such default may entitle the mortgagee to enter, and that the court is still at liberty to exercise its discretion in determining whether the case is one which calls for the appointment of a receiver, or merely for an order requiring the defendant to account for the income, and pay the surplus left after defraying the necessary expenses to the mortgagee, or whether the plaintiff shall be left to the usual legal remedies for obtaining possession, or to his action for damages for refusing to deliver. Even if these remedies are inadequate, that does not constitute an imperative reason for which a court of equity should become active in enforcing specifically a contract which is in its nature a forfeiture of the most stringent character.[4]

[1] Warner *v.* Rising Fawn Iron Co. (1878), 3 Woods, 514, also a ruling of Woods, J.

[2] McLane *v.* Placerville & Sacramento Valley R. Co. (1888), 66 Cal. 606; s. c. 26 Am. & Eng. R. R. Cas. 404.

[3] Williamson *v.* New Albany, etc. R. Co. (1857), 1 Biss. 198, per McLean, J.

In Tome *v.* King (1891), 64 Md. 166; s. c. 21 Atl. Rep. 279, the trustees who were entitled to possession on default asked for a receiver on the ground that some delay would occur in preparing the case for a decree, and that the property would in the meantime suffer. The petition was granted without any questions being made as to the propriety of the appointment.

[4] Union Trust Co. *v.* St. Louis, Iron Mountain, & Southern R. Co. (1877), 4 Dill. 114, per Miller, J., explaining the proper meaning of American Bridge Co. *v.* Heidelbach (1876), 94 U. S. 798, to be that the appointment of a receiver was one of the ways by which, *in a proper case*, the attachment of the income by the creditors before possession was taken by the mortgagee might be prevented, and not as contended by the plaintiff, that such an appointment was the only mode of effecting this, or that an appointment was to follow in every case of foreclosure where the income was mortgaged. In line with this decision is Cheever *v.* Rutland & Burlington R. Co. (1863), 39 Vt. 653, a decision

§ 546. **Appointment of Receivers after Rendition of Foreclosure Decree, when proper.** — After the foreclosure decree is rendered, the bondholders have a right to demand that the earnings of the road shall be received by a disinterested trustee, and the fact that a part of the bondholders are in possession, to the exclusion of others to whom their interests are hostile, is a sufficient reason for appointing a receiver of those earnings at the instance of the latter, unless the interval between the decree and the foreclosure is very short.[1]

ARTICLE III. — REMOVAL, SUBSTITUTION, AND FINAL DISCHARGE OF RECEIVERS.

§ 547. **Generally.** — The cases in which the removal of a receiver is asked for may be divided into two classes: (1) Those in which it is alleged that, owing to circumstances existing at the time the appointment was made, the court ought either to have disallowed the application altogether, or to have appointed some other person than the one actually selected; and (2) those in which the circumstances relied upon to establish the impropriety of permitting the receiver to retain the office have arisen subsequently to the appointment. The second of these classes comprehends both the cases in which the removal of a receiver is asked for merely for the purpose of substituting another in his place, and those in which there is asserted to be no longer any reason why the receivership should be continued.

§ 548. **Power of Removal.** — A court which is invested by statute with the power of appointing a receiver possesses by implication the power of discharging him also.[2]

Ordinarily the question of the removal of a receiver, like the question of his appointment, is a matter resting in the discretion of the court,[3] and the appellate court will not review the propriety of the appointment.[4]

But to this rule there are several exceptions, the reasons for

rendered by Justice Barrett of the Supreme Court of Vermont, while sitting as Chancellor. The bill in that case was for foreclosure, and asked for a receiver. So far as the preliminary interposition of the court was to be invoked, the bill was drawn with the controlling idea that this interposition was to be predicated upon the orator's right to possess as mortgagees with condition broken. The learned judge declined to adopt this view, and said that, as the circumstances were not such as to call for the preservative management of a receiver, the application would be denied.

[1] Benedict *v.* St. Joseph & W. R. Co. (1883), 19 Fed. Rep. 173.

[2] Cincinnati, Sandusky, & Cleveland R. Co. *v.* Sloan (1876), 31 Ohio St. 1.

[3] High on Rec., § 821.

[4] Milwaukee & Minnesota R. Co. *v.* Soutter (1864), 2 Wall. 510.

which are sufficiently obvious, from a statement of the rulings which illustrate them.

Thus it is held that when all the questions in dispute have been passed upon both in the lower and the appellate courts, with the result that the right of the defendants to have the property restored to them, on payment of the amount found to be due, is clearly established, a refusal on the part of the lower court to discharge the receiver is judicial error, which may be examined into on appeal, and the ruling of the lower court will be reversed, if there are no special facts presented to justify the continuation of the receivership.[1]

So, also, as the appointment of a receiver without notice to the defendant is deemed to be a very dangerous exercise of the judicial power, the circumstances of such an appointment will be jealously scrutinized by an appellate tribunal, and if the necessary degree of urgency is not shown to have existed, the receiver will be removed.[2]

So also, if the motion to terminate the receivership is made with the concurrence of all the parties in interest, the entire control of the property should be restored to the owners; and it is an abuse of the court's power to refuse the motion so far as to require the receiver still to receive and disburse the earnings.[3]

The rule is also to some extent modified by statute. Under the Ohio Code, which allows an appeal from "an order affecting a substantial right made in a special proceeding," it has been held that an order discharging a provisional receiver was subject to review.[4]

It is not denied that a court which appoints as ancillary receiver a person who is already acting as receiver under a prior appointment in the court where the proceedings were originally instituted, has an abstract, technical right to remove that receiver if it thinks proper, and put another in his place.[5]

[1] Milwaukee & Minnesota R. Co. *v.* Soutter (1864), 2 Wall. 510. The facts of this case are referred to above.

[2] Wabash Ry. Co. *v.* Dykeman (1892), 133 Ind. 56; s. c. 32 N. E. Rep. 823; Chicago & S. E. Ry. Co. *v.* Cason (1892), 133 Ind. 49; s. c. 32 N. E. Rep. 827. In the first of these cases it was held that the question as to propriety of the appointment could be brought directly to the appellate court without moving in the lower court to have the appointment vacated. Stress was laid on the fact that there was no express statutory right of appeal from a ruling denying a motion to vacate an order appointing a receiver. But if an appointment *ex parte* without sufficient cause may be treated as judicial error, which is the conclusion arrived at, it was apparently not necessary for the appellate court to fortify its position by this technical consideration. See note on these cases, 27 Am. L. Rev. 470.

[3] L'Engle *v.* Florida Central R. Co. (1873), 14 Fla. 266.

[4] Cincinnati, Sandusky, & Cleveland R. Co. *v.* Sloan (1876), 31 Ohio St. 1; s. c. 15 Am. Ry. Rep. 376.

[5] Chattanooga Terminal Ry. Co. *v.* Felton (1895), 69 Fed. Rep. 273.

This course was taken by Judge Gresham in the Wabash case. The rule was strongly insisted upon that a federal court, by appointing a receiver over a railroad system extending through several States, does not acquire such a primary and paramount jurisdiction over the entire property that the court of another district which has appointed the same person as receiver in ancillary proceedings is precluded from entertaining an application for his removal made by holders of bonds secured by sectional mortgages on portions of the property within the latter district.[1]

§ 549. **Jurisdiction to remove Ancillary Receiver.** — An ancillary receiver was also removed by Judge Simonton of the District of South Carolina, but it was on the ground that the receiver had been appointed in the sister court at the instance of another company which controlled the stock of the defendant, to further the interests of the dominant company's system, and not in the interest of the creditors, and also on the ground that the appointing court had in substance afterwards held that its action in the premises was unauthorized, while the proceedings in which the appointment of another receiver was asked for were instituted by creditors seeking to enforce liens and equities paramount to those of any stockholders.[2]

But it is unquestionably more agreeable to those principles of comity which regulate the attitude of the federal courts of the different districts towards one another to decline to consider any application for the removal of a receiver appointed in ancillary proceedings.[3]

In any event, something more than mere unsupported allegations that the original receivership was procured by fraud are necessary to induce a court to remove an ancillary receiver.[4]

§ 550. **Questions which will not be decided upon an Application for Removal.** — Whether a receiver appointed in an action to foreclose a first mortgage, given to secure the payment of bonds, is entitled to receive the income and money previously collected by a receiver appointed in an action to foreclose the second mortgage,

[1] Atkins *v.* Wabash, St. L. & Pac. Ry. Co. (1886), 29 Fed. Rep. 161, Judge Gresham said: "If by the mere force of its orders the other court acquired the legal custody of the *res*, the entire Wabash property, . . . it would be alike the duty and the pleasure of this court to aid that court in the exercise of its primary jurisdiction. But taking a different view, it allowed this bill to proceed here for a foreclosure of the sectional mortgages."

[2] Phinizy *v.* Augusta & K. R. Co. (1893), 56 Fed. Rep. 273.

[3] Chattanooga Terminal Ry. Co. *v.* Felton (1895), 69 Fed. Rep. 273; Dillon *v.* Oregon, etc. Ry. Co. (1895), 66 Fed. Rep. 622.

[4] New York, P. & O. R. Co. *v.* New York, L. E. & W. R. Co. (1893), 58 Fed. Rep. 268.

will not be adjudicated on an application for a removal of the receiver first appointed.[1]

§ 551. **Removal on Account of Circumstances existing at the Time of the Appointment.** — The court will remove a receiver if facts are presented showing that he was not a proper person to place in control.[2]

The fact of a receiver's holding such relations to some of the parties in interest, that his sympathies are likely to predispose him to favor them, is as much a reason for removing him as the fact that he is shown not to possess the necessary integrity and business qualifications. As was said by Mr. Justice Miller, while sitting as circuit justice, "It becomes the duty of the court to see that its powers are exercised on principles of strict neutrality as regards the belligerents." That duty will be discharged by removing a representative of any one of several hostile interests, and appointing a receiver who, in feeling and in conduct, will be strictly neutral and strictly honest.[3]

Thus a receiver appointed by a federal court under the belief that substantially all interests affected were united in the application therefor will be removed, where it appears that he is bitterly opposed by some of the parties interested and was nominated by the other parties, notwithstanding a receiver may have also been appointed by a State court who is a partisan of the parties hostile to the receiver in question.[4]

But where the defendant company has agreed that the complaining bondholders, upon giving a specified security, shall have the possession and management of the railroad, and nominate the receiver, it cannot afterwards object to the person selected, unless he commits some overt act of unfaithfulness to his trust.[5]

If the company has been deprived of the opportunity of resisting the application for a receiver, owing to the fact that the officer on whom service of process was made fraudulently concealed such service, the court will reopen the case and allow the company to vacate the appointment.[6]

So, also, as it is an abuse of the process of the court to procure the appointment of a receiver in a proceeding which is not an adversary one, but really instituted by a collusive arrangement between the petitioner and the company, a receiver appointed on

[1] Holland Trust Co. v. Consolidated Gas & Electric Light Co. (1895), 85 Hun, 454.

[2] High on Rec., § 821.

[3] Meier v. Kansas Pac. Ry. Co. (1878), 5 Dill. 476, 478.

[4] Wood v. Oregon Development Co. (1893), 55 Fed. Rep. 901.

[5] Cowdrey v. Railway Co. (1870), 1 Woods, 331.

[6] Allen v. Dallas & Wichita R. Co. (1878), 3 Woods, 316.

the application of a judgment creditor will be discharged upon proof that the process of the court was not used in good faith to collect the judgment, but as a means of placing the property and business of the company in the hands of the court, to the end that the defendant might not be subject to suits in the ordinary course of judicial proceedings, and in order to enable the plaintiff and defendant, by agreement between them, through the receiver, to apply all the earnings of the road during a series of years to the improvement and betterment of the property.[1]

The appointment will also be vacated where the defendant brings forward material facts, not presented at the first hearing, and shows that his failure to lay them before the court was due to mistakes, inadvertence, or excusable negelect;[2] or where the proceedings were tainted in some way with fraud. Thus a receivership will be vacated upon proof that it was procured through the collusive acquiescence of the defendant.[3]

But the mere fact that the directors, or some of them, who knew that a foreclosure suit was in preparation, and that a receiver was to be applied for as a part of the relief, desired that the petition should be granted, in the belief that it would be prudent and wise to have such receiver appointed, will not render the appointment collusive, nor furnish any adequate reason for vacating it.[4]

§ 552. **Removal of Receiver appointed ex parte.** — The rule that a receiver should not, without some pressing necessity, be appointed in *ex parte* proceedings (see *ante*) involves the correlative proposition, that an *ex parte* appointment should be vacated if it is afterwards shown that it was, under the circumstances, improperly made; as, for example, if his personal interests were such as to furnish a strong temptation to favor one or other of the beneficiaries of the trust he has undertaken. Thus a receiver appointed *ex parte* will be removed where it appears that, though not the owner of any of the corporate stock, he was under agreement to deliver upon demand a large number of

[1] Sage *v.* Memphis & Little Rock R. Co. (1883), 5 McCrary, 643; s. c. 18 Fed. Rep. 571. This case was reversed as a whole by the Supreme Court (125 U. S. 361); but the action and opinion of the lower court in regard to the propriety of the discharge, supposing the facts to be as stated, was expressly approved.

[2] Belmont *v.* Erie Ry. Co. (1869), 52 Barb. 637.

[3] Fifth National Bank of Pittsburg *v.* Pittsburg & Castle Shannon R. Co. (1881), 1 Fed. Rep. 190; Overton *v.* Memphis & Little Rock R. Co. (1882), 10 Fed. Rep. 866; Brassey *v.* New York & New England R. Co., 19 Fed. Rep. 663; Wilson *v.* Barney (1875), 5 Hun, 257.

[4] Brassey *v.* New York & New England R. Co. (1884), 22 Blatch. 72.

shares of such stock, and that every appreciation of the stock would largely reduce his private fortune.[1]

A receiver will not be removed because the application was necessarily made out of court, and without notice, for the purpose of forestalling adverse attacks, and the clerk kept the proceedings secret until the papers were filed.[2]

§ 553. **Right to object to Appointment lost by Delay.** — It has been held that, after a receiver has gone forward and completed the road to a certain point, expending money and materials furnished, not by the company, but by other parties interested in its completion, and thereby saved the charter of the company, and prevented a forfeiture of its land-grant, the delay of the company for nearly a month to object to the manner in which it was served with notice of the foreclosure suit will be regarded as an acquiescence in the action of the court and an estoppel of objections on its part. The company's motion to vacate the appointment of the receiver under such circumstances will be denied.[3]

A receiver appointed in foreclosure proceedings will not be removed on the application of one appointed receiver in sequestration proceedings, where the application is not made until after the final judgment and decree of foreclosure, and until after the latter receiver has lost in an effort to defeat such action.[4]

§ 554. **Removal of Receivers on Account of Circumstances arising subsequent to the Appointment.** — Any conduct amounting to an abuse of his fiduciary position is a sufficient ground for removing a receiver. Thus a receiver has been removed on the ground that, while managing the road, he allowed large rebates in favor of another railway company owned by persons whose business interests were identified with his own, and also in favor of a coal company in which he was a shareholder, and that he co-operated with a purchasing committee, which was seeking to purchase the road, in its efforts to compel, by threats of prolonged and expensive litigation, a minority of dissenting bondholders to agree to the sale.[5]

But a receiver of a railroad will not be removed because of the organization of a company composed of the officers of the road, which is alleged to have used the labor of the railroad company

[1] Olmstead *v.* Distilling & Cattle Feeding Co. (1895), 67 Fed. Rep. 24.

[2] Ibid.

[3] Allen *v.* Dallas & Wichita R. Co. (1878), 3 Woods, 316, 334; s. c. 1 Fed. Cas. 465, Case No. 221.

[4] New York Security & Trust Co. *v.* Saratoga Gas & Electric Light Co. (1895), 88 Hun, 569.

[5] Beers *v.* Wabash, St. L. & Pac. Ry. Co. (1886), 29 Fed. Rep. 161; s. c. 26 Am. & Eng. R. R. Cas. 441.

in operating a mine, where he is not shown to have knowledge of, or consented to, such use of the labor.[1]

Nor is it a ground for the removal of the receivers of a corporation that one of them has become a member of a reorganization scheme. It will be sufficient if that receiver retires from membership in such committee when conflict over the plan of reorganization appears imminent.[2]

Still less should a receiver be removed merely because he advises, aids, and encourages reorganization schemes.[3]

The following have also been declared to be insufficient grounds for removing a receiver: Making misleading reports as to the condition of the property, where it was shown that he had continued the method of accounting and reporting employed by the directors; fraudulent conduct of his agent to the detriment of the estate, where he was shown to have used due care in the selection of his agents, and to have discharged the agent as soon as he had ascertained the fraud; giving an unusually low rate for the carriage of certain freight, where his object was to bring an article produced on the line of the road into general demand, and so add to the receipts of the trust estate; yielding to a demand made by another company under a reasonable construction of a contract between it and the insolvent company.[4]

A court will remove receivers who are incompetent, especially where some of them have interests in other corporations adverse to the interests of a minority of the bondholders, and, at the instigation of the majority of such bondholders, are using their powers and influence as receivers in advancing those corporations at the expense of the railroad.[5]

A receiver who has unjustly discriminated in the charges imposed on rival shippers over the road may be removed for such discrimination.[6]

But a receiver of a railroad company will not be removed because of fraudulent acts or misconduct of a subordinate employee, when his personal presence and actual inspection of the transactions of such agent is a physical impossibility, and the agent was discharged upon the transactions coming to the knowledge of the receiver.[7]

[1] Clarke *v.* Central Railroad & Bkg. Co. (1893), 66 Fed. Rep. 16.

[2] Fowler *v.* Jarvis-Conklin Mortgage Co. (1894), 63 Fed. Rep. 888.

[3] Clarke *v.* Central Railroad & Bkg. Co. (1893), 66 Fed. Rep. 16.

[4] Ibid.

[5] Atkins *v.* Wabash, St. L. & Pac. Ry. Co. (1886), 29 Fed. Rep. 161, 174.

[6] Handy *v.* Cleveland & M. R. Co. (1887), 31 Fed. Rep. 689.

[7] Clarke *v.* Central Railroad & Bkg. Co. (1893), 66 Fed. Rep. 16.

Nor is it a ground for the removal of a receiver that mortgages securing debentures may have been sold at a sacrifice without adequate advertisement or opportunity to bidders, inasmuch as the power to sell such mortgages does not rest with the receivers, but with the trustees, who are not under the control of the court or the receivers.[1]

Nor will such a receiver be removed because, in the exercise of his business judgment, for the purpose of introducing the product of a mine, he has given a special freight rate which is too low.[2]

If receivers representing two different interests, who have been placed by agreement in charge of the property, cease to act harmoniously, they should be removed and a single one appointed.[3]

When it is represented that the trust property has fallen into the hands of different receivers accountable to three different courts, to the manifest detriment of the trust estate, that fact of itself is a sufficient reason for the appointment of a receiver for the whole property, if the court has jurisdiction to make such appointment.[4]

§ 555. **Termination of Receivership generally.** — In appointing a receiver, whether at the commencement or during the progress of the suit, the court may limit the duration of the receivership to such a period as it may deem to be expedient.[5]

If no such limit of time has been fixed beforehand, the court acts with reference to the principle that a receiver is appointed essentially for the purpose of winding up the affairs of the defendant, and that the receivership should therefore be closed at the earliest possible moment consistent with the interests of the creditors and stockholders.[6]

[1] Fowler *v.* Jarvis-Conklin Mortgage Co. (1894), 63 Fed. Rep. 888.

[2] Clarke *v.* Central Railroad & Bkg. Co. (1893), 66 Fed. Rep. 19.

[3] Meier *v.* Kansas Pac. R. Co. (1878), 5 Dill. 476; s. c. 16 Fed. Cas. 1321, Case No. 9395.

[4] Wilmer *v.* Atlanta & Richmond Air Line R. Co. (1875), 2 Woods, 409.

[5] Gilman *v.* Illinois & Mississippi Tel. Co. (1875), 91 U. S. 603, 616.

[6] Howard *v.* La Crosse & Milwaukee R. Co. (1864), Woolworth, 49; s. c. on appeal, *sub nomine* Railroad Co. *v.* Soutter (1864), 2 Wall. 510; s. p. Mercantile Loan & Trust Co. *v.* Missouri, K. & T. Ry. Co. (1888), 36 Fed. Rep. 221; 4 Ry. Rep. & Corp. L. J. 362; Taylor *v.* Phil. & Read. R. Co., 7 Fed. Rep. 377; s. c. 3 Am. & Eng. R. R. Cas. 177 and note; Sewell *v.* Cape May R. Co. (N. J. Eq., 1887), 30 Am. & Eng. R. R. Cas. 155; Vermont & Canada R. Co. *v.* Vermont Central R. Co. (1877), 50 N. Y. 500; s. c. 14 Am. Ry. Rep. 497. In the last case the court stated the principle as follows: "A receivership is temporary to serve an existing exigency of a temporary nature, and when that is done, it is to cease. The idea that a court, in virtue of its prerogative in that behalf, is to take upon itself the office of instituting a receivership to be perpetual, and to do the duty of a court in controlling, directing, and enforcing the administration

Thus a receiver should be discharged when the accrued interest has been paid in full, and the mortgagees have ample security for the remainder of their debt, and a speedy and sure means of enforcing its payment in case default be made therein.[1]

Where an appointment has been made in a State court on an *ex parte* application, and the cause afterwards removed to the federal court, and both sides heard, the order will be rescinded upon its being satisfactorily shown that the property is not in any jeopardy or in any need of the protection of the court.[2]

A receiver is appointed for the benefit of the creditor at whose instance he is appointed, and such creditor is therefore under no obligation to continue the receivership any longer than he deems expedient. When he petitions to have the receivership closed, the court will not retain control of the property until the costs and expenses of its management during the receivership have been paid. The fact that the indebtedness created by the receiver has enhanced the value of the property is no ground for such retention.[3]

The receivership should not be continued any longer than the time required to obtain and execute by the exercise of reasonable

in the management of the parties interested, and not to serve a present exigency, rendering it necessary in order to prevent a failure of legal justice and right, has not yet been propounded in any book on the subject, nor entertained and acted on in any case." A receiver which a New Jersey statute allows to be appointed upon the petition of any citizen, after it has ceased to operate its road for a given period, will be discharged, when the company satisfies the court of its willingness to resume the operation of the road. *In re* Long Branch & Sea Shore R. Co. (1874), 24 N. J. Eq. 398. But before the company is given possession of the road, it must establish not only its ability and willingness to operate the road, but also its right to the possession of the property. *In re* Long Branch R. Co., 24 N. J. Eq. 402. As a general rule the road will be returned to the company which was in possession when the receiver was appointed, and the right of any other company to the possession of the road determined in proceedings instituted by the latter, asking that the property be delivered to it, especially if the other company is not made a party to the suit.

See article Discharge of Receiver — Effect upon Liabilities incurred during the Receivership, by Charles L. Billings, 23 Am. L. Reg. N. S. 593.

A disputed claim of this character must be settled between the opposing parties in due course of law. Long Branch Sea Shore Railroad Co. *v.* Sneden (1875), 26 N. J. Eq. 539.

[1] Howard *v.* La Crosse & Milwaukee R. Co. (1864), Woolworth, 49; same case on appeal, Railroad Co. *v.* Soutter (1864), 2 Wall. 510. In this case it was held that a road with annual receipts to the amount of $800,000 will not be retained in the hands of a receiver for a claim of $20,000, especially when the validity of the lien asserted is extremely doubtful, and the creditor, during the period of four years, which had elapsed since the appointment of the receiver, had been paid only $1,000 of his demand, and taken no step in the cause to assert his rights. The ordinary remedies are sufficient in such a case.

[2] McHenry *v.* New York, P. & O. R. Co. (1885), 25 Fed. Rep. 114.

[3] State of Tennessee *v.* Edgefield & Kentucky R. Co. (1880), 6 Lea (Tenn.), 353; s. c. 4 Am. & Eng. R. R. Cas. 87.

diligence a final decree. Any delay or want of good faith in this respect on the part of the plaintiff should result in an immediate discharge of the receiver.[1]

§ 556. **No Formal Discharge by the Court is necessary to terminate a Receivership.** — This is so when the parties themselves have by their own agreement provided for the administration of the trust estate in such a manner that there is no longer any property left in the custody of the court for the receivers to manage.[2]

§ 557. **The Receiver himself cannot be heard in Opposition to a Motion** for the termination of the receivership, which is concurred in by all the parties in interest. He is not such a party himself until his accounts come up for adjustment.[3]

§ 558. **Effect of the Discharge of a Receiver as regards the Rights of Third Parties.** — After an order discharging a receiver and directing a surrender of the property to the defendant has been entered and complied with, the court cannot, after the close of the term, alter, modify, or expand such order in any way, and again obtain jurisdiction over the property and funds already surrendered, with a view to the adjustment and payment of claims against the receiver which were not reviewed in the order of discharge.[4]

Nor can action be maintained against the receiver after such discharge and surrender of property upon the order of the court.[5]

Upon the discharge of the receiver, a party who may have taken a lease of the road as a security for a large debt, before possession was taken by the receiver, is entitled to be placed in possession again; but this rule is not applicable to a lessee who, by reason of his failure to pay the sums stipulated in the contract, may have lost possession shortly before the appointment of the receiver, especially when the validity of his lien is doubtful; and not only is the security sufficient for any lien he may have, but he has never, although a party to all the suits respecting the road during a period of four years, set up a claim to any relief.[6]

[1] Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 260, 269.

[2] Andrews *v.* Smith (1881), 5 Fed Rep. 833, 845; Vermont & Canada R. Co. *v.* Vermont Central R. Co. (1877), 50 Vt. 500; s. c. 14 Am. Ry. Rep. 497.

[3] L'Engle *v.* Florida Central R. Co. (1873), 14 Fla. 266.

[4] Davis *v.* Duncan (1884), 19 Fed. Rep. 477.

[5] Farmers' Loan & Trust Co. *v.* Central Railroad of Iowa (1880), 7 Fed. Rep. 537.

[6] Howard *v.* La Crosse & Milwaukee R. Co. (1884), Woolworth, 49.

CHAPTER XXVII.

TITLE, POSSESSION, OFFICE, AND DUTIES OF RECEIVERS.

ARTICLE I. — TITLE AND POSSESSION GENERALLY.

§ 559. **Existing Rights not changed by Appointment of Receiver.** —The appointment of a receiver alters no existing rights in respect to the property seized. It merely stays the enforcement of rights by the parties in interest for the time being, and in this respect operates like an injunction *pendente lite*,[1] or an equitable attachment, the property being put into his possession for the benefit of the party ultimately entitled.[2]

A receiver of a corporation is vested with title to its property from the date of the order appointing him.[3] And from the time of the order of appointment both parties are in possession by the hand of the receiver; and when the question of right is ultimately decided, the possession of the party prevailing becomes exclusive throughout the whole period, by relation to the date of the order.[4]

The possession of the receiver, therefore, does not disturb the priority of legal or equitable liens.[5]

Nor is any formal assignment to the receiver requisite to enable the court to pass title to a purchaser through a sale made by a receiver acting under its orders.[6]

[1] Poland *v.* Lamoille Valley R. Co. (1879), 52 Vt. 144; s. c. 4 Am. & Eng. R. R. Cas. 408; Willink *v.* Morris Canal & Bkg. Co. (1843), 4 N. J. Eq. 377; Union Trust Co. *v.* Weber (1880), 96 Ill. 346; s. c. 3 Am. & Eng. R. R. Cas. 583; Fosdick *v.* Schall (1879), 99 U. S. 235, 251; Hart *v.* Barney & Smith Mfg. Co. (1881), 7 Fed. Rep. 543; Ellis *v.* Boston, Hartford, & Erie R. Co. (1871), 107 Mass. 1.

[2] Union Bank of Chicago *v.* Bank of Kansas City (1890), 136 U. S. 223; s. c. 10 Sup. Ct. Rep. 1013.

[3] Dickey *v.* Bates *et al.* (1895), 13 Misc. Rep. 489; s. c. 35 N. Y. Suppl. 525.

[4] Beverley *v.* Brooke (1847), 4 Gratt. (Va.) 187, citing Story's Eq. 134.

[5] Wiswall *v.* Sampson (1852), 14 How. 52; Central Trust Co. *v.* Tex. & St. Louis R. Co. (1885), 23 Fed. Rep. 673; Poland *v.* Lamoille Valley R. Co. (1879), 52 Vt. 144; s. c. 4 Am. & Eng. R. R. Cas. 408; Chicago Title & Trust Co. *v.* Smith (1895), 158 Ill. 417.

[6] Russell *v.* Texas & Pac. Ry. Co. (1887), 68 Tex. 646; s. c. 5 S. W. Rep. 686.

The general practice seems to be that, when it is necessary for the recovery or preservation of personal property by the receiver, the defendant will be required to convey the property by proper written assignments, and that, when it is necessary to execute leases, or to bring suits of ejectment, etc., for real estate, a conveyance shall be made to the receiver.[1]

§ 560. **Of what Property a Receiver acquires Title.** — If the receiver is merely directed in general terms to take charge of the property covered by the mortgage, the extent of the protection afforded by the receivership must be determined by the same principles as those which determine the scope of the mortgage lien. (See previous chapters on mortgages.) Lands not embraced in the mortgage, and not alluded to specifically in the order of appointment, may be sold on execution. The mere fact that the rents of such lands have been paid to the receiver is not sufficient notice to the public that they are claimed as being subject to the mortgage lien.[2]

The principle that the income of the road belongs to the company as long as it is rightfully in possession, involves the consequence that earnings in its hands derived from the operation of the road prior to the appointment of the receiver do not pass under the control of the latter, though there may be provisions in the order of appointment as to paying past due claims. Such provisions flow from the mere discretion of the Chancellor, and cannot be made the basis of an invasion of the absolute right of the mortgagor.[3]

Only the property in possession of the company at the time of the appointment of the receiver can in any case become subject to his control. Hence a receiver who is directed to take possession of a railroad, "its depots, etc., and also all other goods and chattels owned by such company," etc., and is empowered "to institute suits to recover or protect any of its property," is not authorized to take possession of lumber and cord-wood sold upon execution prior to his appointment.[4]

[1] Union Trust Co. *v.* Weber (1880), 96 Ill. 346; s. c. 3 Am. & Eng. R. R. Cas. 583.

As to title of receiver, see Atty.-Gen. *v.* Sittingbourne & Sheerness Ry. Co., 14 L. T. N. S. Ch. 92.

[2] Mississippi Valley Co. *v.* Chicago, St. Louis, & N. O. R. Co. (1881), 58 Miss. 846; s. c. 2 Am. & Eng. R. R. Cas. 414.

[3] Dow *v.* Memphis & Litttle Rock R. Co. (1884), 20 Fed. Rep. 768; Hook *v.* Bosworth (1894), 64 Fed. Rep. 443; s. c. 12 C. C. A. 208. Compare Gilman *v.* Illinois & Miss. Tel. Co. (1875), 91 U. S. 603, 614, and the cases cited in previous chapters.

[4] McIlrath *v.* Snure (1876), 22 Minn. 391. The court expressly declined to inquire what the rights of the trustees were

So also the holder of a judgment constituting a lien on real estate of a railroad, not embraced in mortgages under which a receiver was appointed, is entitled to have such land discharged from the custody of the receiver, so that it may be sold to satisfy the judgment.[1]

It has been held that an order appointing a receiver, which includes the words "all other rights or property whatsoever," does not cover certain town lots afterwards acquired, although the mortgage itself to enforce which the suit was begun specifically embraces such property.[2]

§ 561. **Jurisdiction of Property illegally in the Custody of Receiver.** — The court appointing the receiver has jurisdiction to decide all conflicting rights in regard to property illegally in the possession of its officer, provided such property was taken under color of its authority. Personalty not embraced in the mortgage, and therefore not within the terms of a decree of sale not professing to cover any property except that which was mortgaged, will be treated as a part of the trust estate, where all the parties to the suit have expressly consented to the decree. Thereafter the court appointing the receiver will not allow any of those parties to obtain an unfair advantage over the other creditors by instituting proceedings in another court, and levying on personalty which is not subject to the mortgage lien.[3]

§ 562. **Interference with Possession by Strikers.**[4] — Since property in a receiver's hands is *in custodia legis*, any act which amounts to a positive obstruction of the receiver in the management of the property may be treated as a contempt of court, and punished accordingly. This principle has been applied several times in recent years in regard to "strikers." The rule adopted

in regard to these chattels. The rule governing the cases in which a levy is made upon such chattels, when covered by the after-acquired clause (it is not stated in the report whether the lien in this case covered the subject-matter of the suit), is discussed in Chapter X.

[1] Scott *v.* Farmers' Loan & Trust Co. (C. C. A., 1895), 69 Fed. Rep. 17.

[2] Gabert *v.* Olcott (Tex. Civ. App., 1893), 22 S. W. Rep. 286. The correctness of this decision is clearly doubtful.

Where a municipal subscription to stock of a railroad company is transferred to a contractor, who in turn assigna it to another for a loan of money, although the company may have agreed to enforce the same for the benefit of the assignee, a receiver of such company afterwards appointed is under no legal obligation to enforce it, as the naked legal title to the subscription would not pass to the receiver, only the power, right, and title to such property passing to him by his appointment as is necessary to a discharge of his duties. Coler *v.* Grainger County *et al.* (1896), 74 Fed. Rep. 16.

[3] Farmers' Loan & Trust Co. *v.* San Diego Street Car Co. (1892), 49 Fed. Rep. 188, citing Gumbel *v.* Pitkin, 124 U. S. 131.

[4] As to injunction against strikes by a receiver's employees, see the note 28 Lawyers' Rep. Ann. 464. See also § 575, *post.*

by the courts for dealing with such cases may be stated thus: "Where employees of a railroad company in the hands of a receiver appointed by the court are dissatisfied with the wages paid by the receiver, they may abandon the employment, and, by persuasion or argument, induce other employees to do the same; but if they resort to threats or violence to induce the others to leave, or accomplish their purpose without actual violence, by overawing the others by preconcerted demonstrations of force, and thus prevent the receiver from operating the road, they are guilty of a contempt of court, and may be punished for their unlawful acts."[1]

Any employees who feel themselves aggrieved may always apply to the court which is managing the property, and their complaints will be heard, and proper instructions given to the receiver accordingly.[2]

§ 563. **Possession not allowed to interfere with Public Improvements.** — A federal court will not allow its possession of the property to operate as an obstacle to public improvements authorized by a municipality. Permission will, therefore, be granted to another company to lay its tracts in front of the depot, and across the line, of the company whose road is being administered by the court, provided the petitioner is armed with the necessary legal powers. The court will not in such a case undertake to determine what compensation, if any, is proper for such injuries as may result to the road under its control. Such questions will be relegated to the State tribunals; but, in view of the temporary character of the receiver's control, the court will protect the interests of the parties

[1] United States *v.* Kane (1885), 23 Fed. Rep. 748; s. c. 25 Am. & Eng. R. R. Cas. 608. To the same effect, see *In re* Higgins (1886), 27 Fed. Rep. 443; *In re* Wabash Ry. Co. (1885), 24 Fed. Rep. 217 (of which a summary is given of this case in the note appended to the report of United States *v.* Kane, *supra*, in the American and English Railroad Cases); *In re* Doolittle (1888), 23 Fed. Rep. 544; Beers *v.* Wabash, St. Louis, & Pac. R. Co. (1888), 34 Fed. Rep. 244, 1247; Secor *v.* Toledo, Peoria, & Warsaw Ry. Co. (1877), 7 Biss. 513; King *v.* Ohio & Mississippi Ry. Co. (1877), 7 Biss. 529.

The most elaborate examination of the cases, and what must now be regarded as the most authoritative statement of the rule governing the action of a court of equity in such cases, is to be found in the able and learned opinion recently delivered by Mr. Justice Harlan for the Circuit Court of Appeals in Arthur *v.* Oakes (1894), 63 Fed. 310, the doctrines of which case are approved and the case cited in U. S. *v.* Elliott (1894), 64 Fed. Rep. 27, 32; Union Trust Co. *v.* Atchison, T. & S. F. R. Co. (1894), 64 Fed. Rep. 724, 763; Platt *v.* Phil. & Read. R. Co. (1894), 65 Fed. Rep. 660, 663, 666; U. S. *v.* Cassidy (1895), 67 Fed. Rep. 698, 764; Oxley Stave Co. *v.* Coopers' International Union of N. A. (1896), 72 Fed. Rep. 695, 698; Elder *v.* Whitesides (1895), 72 Fed. Rep. 724, 725.

[2] *In re* Doolittle (1885), 23 Fed. Rep. 544.

who may subsequently come into possession of the mortgaged property by requiring the petitioner to give security for any damages that may ultimately be awarded against it.[1]

§ 564. **Exercise of Corporate Franchises by Company after Appointment of Receiver.** — The appointment of a receiver for a corporation gives him only the temporary control of its affairs under the direction of the court. The corporation may, notwithstanding the appointment, exercise any of its franchises, provided it does not interfere with the rightful management of its affairs by the receiver, so far as his duties are defined by the court appointing him.[2]

Sometimes even this limited exercise of the franchises is expressly forbidden by the order of appointment. But such a restriction may be modified so far as to allow the stockholders to meet for the election of directors; and if the directors then refuse to grant an application of the stockholders to call a meeting at the time designated in the by-law, the court may direct an election conforming as nearly as possible to the by-laws of the corporation.[3]

It seems, however, that a court will ordinarily confine itself to the exercise of such functions as will secure the proper object aimed at by the appointment of the receiver, viz. the preservation of the property, and will therefore refuse to entertain jurisdiction of a question submitted by the company as to the propriety of postponing a meeting for the election of officers, unless that question has some relation to the object for which the receiver was appointed.[4]

The right of the stockholders to elect directors is not affected by the sale of the corporate property by the receivers.[5]

§ 565. **Duty of Officers to deliver Corporate Property to Receiver.** — The officers of the company cannot justify a refusal to account with the receiver, and pay over to him the corporate effects, on the ground that such accounting and assignment is not expressly required in the order of appointment. It is sufficient that such order invests the receiver "with the usual rights and powers of receivers," and especially with power "to receive into

[1] Central Trust Co. *v.* Wabash, St. Louis, & Pac. Ry. Co. (1885), 26 Fed. Rep. 3, per Brewer, J.

[2] Ohio & Mississippi R. Co. *v.* Russell (1885), 115 Ill. 52; s. c. 23 Am. & Eng. R. R. Cas. 149; Stevenson *v.* Davison (1868), 18 Gratt. (Va.) 819.

[3] Lehigh Coal & Navigation Co. *v.* Central Railroad Co. of New Jersey (1882), 35 N. J. Eq. 349; s. c. 9 Am. & Eng. R. R. Cas. 512.

[4] Taylor *v.* Philadelphia & Reading R. Co. (1881), 7 Fed. Rep. 381, 385.

[5] State, *ex rel.*, etc. *v.* Merchant, 37 Ohio St. 251; s. c. 9 Am. & Eng. R. R. Cas. 516.

his possession all the effects and *choses in action*" of the company, for this direction involves the correlative duty of delivery by the officers.[1]

ARTICLE II. — TERRITORIAL LIMITS OF JURISDICTION OF COURT APPOINTING A RECEIVER.[2]

§ 566. **General Rule.** — The process of a court cannot be effective outside the territory over which it has jurisdiction.[3]

Hence a court cannot acquire extra-territorial jurisdiction over property by the appointment of a receiver; and receivers appointed by courts of one jurisdiction are not entitled, as of right, to recognition in another jurisdiction.[4]

This rule is applicable to courts of the same State whose jurisdiction only extends over a limited judicial district.[5]

The doctrine that the powers of a receiver are coextensive only with the jurisdiction of the court appointing him is not, however, to be applied so as to deprive him of the control over property which he has once assumed, merely for the reason that the property is removed into another jurisdiction, provided such removal is in the regular performance of his duty, and not for an unlawful purpose.[6]

A receiver's right of action is frequently recognized as a matter of comity in States other than that of his appointment, where the right asserted is not in conflict with the rights of the citizens of the latter State, nor against the policy of its laws.[7]

Thus a receiver appointed in one State in a suit to foreclose a mortgage covering the rolling-stock of the company has been permitted to assert his right to the possession of a part of it by an action brought in another State where such part was temporarily situated.

[1] Young *v.* Rollins (1884), 90 N. C. 125; s. c. 25 Am. & Eng. R. R. Cas. 646.

[2] See generally the notes in 23 Lawyers' Rep. Ann. 52; 6 id. 792. As to the appointment and removal of ancillary receivers, see *ante*.

[3] Ableman *v.* Booth (1859), 21 How. 506, 524; Pennoyer *v.* Neff (1877), 95 U. S. 714.

[4] Booth *v.* Clarke (1854), 17 How. 322; Beers *v.* Wabash, St. Louis, & Pac. Ry. Co (1886), 34 Fed. Rep. 244; s. c. 26 Am. & Eng. R. R. Cas. 441; High on Rec., §§ 47 *et seq.*, 239, 240.

[5] Florida *v.* Jacksonville, P. & M. R. Co. (1875), 15 Fla. 201.

[6] Chicago, Milwaukee, & St. Paul Ry. Co. *v.* Keokuk National Line Packet Co. (1884), 108 Ill. 317; s. c. 48 Am. Rep. 557.

[7] High on Rec., §§ 341 *et seq.* A note in which the cases illustrating the stricter and more liberal views as to the recognition of receivers in courts of other jurisdiction are classified will be found in 4 Cent. L. J. 6.

Where attachments have been levied on the property of a foreign corporation, and a receiver is afterwards appointed in its own State, and takes possession of all the property, including that levied on, subject to the disposition of the attachments, it is not a proper mode of effecting such disposition for the receiver to petition the courts where the attachments are pending to order the property to be turned over to him. The only way in which it is open to him to contest the attachment suits is to apply to these courts, and obtain permission to become a party to the suits.[1]

§ 567. **General Rule not affected by Fact that Road extends into another State or Judicial District.** — Except to the extent and in the manner stated in the following section, a receiver appointed in one jurisdiction has no absolute right to control any of the property of the company which lies in other jurisdictions.[2]

The admission that there is a necessity for thus calling in the aid of an ancillary jurisdiction amounts to a concession that the tribunal having primary jurisdiction is destitute of power over property situated in another State or district.[3]

A receiver appointed in such ancillary proceedings may at any time be removed for cause by the court which appointed him, especially if the order of the appointment reserves the power to make such further orders as may be necessary.[4]

If the receiver is thus removed, the court which originally ap-

[1] South Carolina R. Co. *v.* People's Savings Ins. (1879), 64 Ga. 18; s. c. 12 Am. & Eng. R. R. Cas. 432.

[2] In Owens *v.* Ohio Central R. Co. (1884), 20 Fed. Rep. 10, the court having come to the conclusion that, by the prior service of process, it had acquired jurisdiction of the trust estate, entered an order extending the jurisdiction of the receiver over that part of the line which lay in another circuit, and directing him, in case he should be obstructed by any one claiming to act as receiver in the latter circuit, to apply to the court of that circuit, praying it to modify or vacate its order appointing such receiver. This course was justified on the grounds that "the court which first takes jurisdiction of a trust estate has the legal right to administer upon the whole." The direction given to the receiver as to the course to be adopted, if he should be obstructed in the second circuit, shows that the learned judge who decided this case did not intend to enunciate any doctrine opposed to that which limits the exercise of the administrative powers of a receiver to the State or judicial district over which the appointing court has jurisdiction. The sweeping rule stated respecting the control of a trust estate is clearly subject to this implied qualification. Any official acts which the receiver may undertake to perform in extra-territorial jurisdictions are valid only in so far as the courts may, as a matter of comity, sanction them. In practice this difficulty is usually obviated by the institution of ancillary proceedings in the other States or districts through which the line may pass, and the appointment of the same receivers by all the courts, as in the Wabash Litigation Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1886), 29 Fed. Rep. 618, and in Jennings *v.* Philadelphia & Reading R. Co. (1884), 23 Fed. Rep. 569.

[3] Texas & Pac. Ry. Co. *v.* Gay (1894), 86 Tex. 571; s. c. 26 S. W. Rep. 599.

[4] Atkins *v.* Wabash, St. Louis, & Pac. R. Co. (1886), 29 Fed. Rep. 161.

pointed him will direct him to surrender all that portion of the property which lies within the jurisdiction of the second court, and make such orders as may be necessary to apportion the expenses already incurred during the receivership among the several sections of the system, and in other ways to protect the sections which still remain under control. The first court will, however, retain its jurisdiction of any causes pending therein.[1]

As to the appointment of receivers in ancillary proceedings in other districts or States, see *ante*, Chap. XXVI.

§ 568. **Ancillary Courts exercise only a Limited Jurisdiction over the Property.** — It has been asserted in one case that, although ancillary proceedings for the appointment of receivers may have been taken in other courts, the court which has control of the main suit and of the funds of the receivership is the proper tribunal in which to litigate claims which may affect the disposition of those funds.[2]

In the light of the other authorities, however, it seems that this rule can scarcely be sustained in all its strictness. It has been declared that a Circuit Court which appoints the original receivers in ancillary proceedings to take charge of the property in its own district has jurisdiction to determine the validity and amount of the claims of citizens of that district against the receivers and the corporation, the broad ground being taken that citizens of one district will not be required to go into another to assert their claims.[3]

In another case the ancillary court consented to sign an order for the payment of a certain claim for supplies for the company prior to the receiver's appointment, making it payable out of the income of the road, but declined to charge it upon the

[1] Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1886), 29 Fed Rep. 618, where the several orders to be made under the circumstances are stated in informal terms by Judge Brewer.

[2] Central Trust Co. *v.* East Tennessee, Va. & Ga. R. Co. (1886), 30 Fed. Rep. 895.

[3] Ames *v.* Union Pac. R. Co. (1894), 60 Fed. Rep. 966. The reason here assigned is somewhat analogous to that which has led to the insertion in some orders of appointment of a provision authorizing suits against a receiver appointed in a federal court in any *county* through which the road passes. See, for example, Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 260; s. c. 17 Am. & Eng. R. R. Cas. 324, where Judge Caldwell declared that the saving of expense to the company and the bondholders, which will result if the litigation growing out of the operation of the line of railroad, with its manifold and complicated business relations, is concentrated in a single court, is not sufficient to outweigh the inconveniences which persons dealing with the road will be put to by such an arrangement, and that it is not necessary, for the accomplishment of the purposes for which receivers are appointed, to impose such burdens and deprivations upon the citizen, and neither the railroad company nor the bondholders have any equity to ask it.

corpus, except upon an order by the court in which the principal receivership was created.[1]

Possibly, too, the ancillary court may enforce a claim which has been reduced to judgment before the appointment of a receiver, if by the law of the State that judgment constitutes a lien on the real estate of the company.[2]

§ 569. **Operation of General Rule qualified by Powers of a Court of Equity to act in Personam.** — A court which has jurisdiction of a consolidated corporation created by the concurrent legislation of several States over which a line of railway extends, may appoint a receiver for the whole property, and through its personal control of the corporation reach the corporate property which lies outside the territorial limits of its own jurisdiction.[3]

For this purpose it may compel the corporation to execute assignments to the receiver.[4]

If the court's personal control of the company is not adequate for the purpose of enabling the receiver to obtain possession of property outside the territorial jurisdiction of the court, as where such property has been seized by other persons, it will of course be necessary to ask the assistance of the court in whose jurisdiction those persons are living; but ordinarily such assistance will be freely given as a matter of comity.[5]

[1] United States Trust Co. *v.* New York, W. S. & B. R. Co. (1885), 25 Fed. Rep. 797.

[2] Jennings *v.* Philadelphia & Reading R. Co. (1884), 23 Fed. Rep. 569. The application in this case was supported on the ground that the plaintiff had acquired a lien at the time the receivership began. The court held that no such lien had been acquired, and therefore denied the application. But the opinion does not show quite clearly whether, if the lien had been shown to exist, the plaintiff would have been given relief in the ancillary tribunal, or referred to the one in which the receivers had first been appointed. If the first course had been adopted, it would apparently have been in deference to the peculiar effect of the State law; for it seems clear that the mere fact of a claim having been reduced to judgment ought not to affect the operation of the general principle which makes the original court the proper forum for the settlement of all claims upon the funds of the receivership. In Central Trust Co. *v.* East Tennessee, Va. & Ga. R. Co., *supra*, the court points out, *arguendo*, that if "any one has a lien on such funds, or on the property of the company by reason of such funds, say for a judgment recovered against the company prior to the receivership, an accounting and marshalling of liens must be had; and accounting and marshalling must be had in one court or inextricable confusion would result." The main principle is not disputed that the receivers must report to and be governed by the court from which the original order of appointment issued in all matters relating to the general management of the trust, their general accounting, and their general operation of the road within the territorial limits of that court's jurisdiction. Ames *v.* Union Pac. R. Co. (1894), 60 Fed. Rep. 966.

[3] Wilmer *v.* Atlanta & Richmond Air Line R. Co. (1875), 2 Woods, 409.

[4] Muller *v.* Dows (1876), 94 U. S. 444; Northern Indiana R. Co. *v.* Michigan Central R. Co. (1853), 15 How. 233.

[5] Wilmer *v.* Atlanta & Richmond Air Line R. Co. (1875), 2 Woods, 409.

ARTICLE III. — OFFICE AND DUTIES OF RECEIVERS.

§ 570. **Nature of Office generally.** — "The jurisdiction of the court to appoint receivers of property has for its primary object the care and custody of the property which is the subject of the receivership, pending the determination of the questions involved in the litigation, and to enable the court, by placing the property under the control of its officer, to preserve it to answer the final decree which may be made in the action." [1]

[1] Vilas *v.* Page (1887), 106 N. Y. 439, per Andrews, J. In England a distinction is drawn between a receiver and a manager. A receiver means "a person who receives rents or other income, but does not manage the property in the sense of buying or selling, or anything of that kind." If it is desired to continue the business, it is necessary to appoint a manager, or a receiver and manager. *In re* Manchester R. Co., L. R. 14 Ch. Div. 653 (per Jessel, M. R.). This principle was established in regard to railroads by the leading case of Gardner *v.* London, C. & D. Ry. Co., L. R. 2 Ch. 201, where application was made by the mortgagees for a receiver. Lord Cairns summed up the opinion of the court in the following words: "In addition to the general principle that the Court of Chancery will not in any case assume the permanent management of a business or undertaking, there is that peculiarity in the undertaking for a railway which would, in my opinion, make it improper for the Court of Chancery to assume the management of it at all. When Parliament, acting for the public interest, authorizes the construction and maintenance of a railway, both as a highway for the public, and as a road on which the company may themselves become carriers of passengers and goods, it confers powers and imposes duties and responsibilities of the largest and most important kind, and it confers and imposes them upon the company which Parliament has before it, and upon no other body of persons. These powers must be executed and these duties discharged by the company. They cannot be delegated or transferred. The company will, of course, act by its servants, for a corporation cannot act otherwise; but the responsibility will be that of the company. The company could not, by agreements, hand over the management of the railway to the debenture-holders. It is impossible to suppose that the Court of Chancery can make itself or its officer, without any parliamentary authority, the hand to execute these powers; and all the more impossible when it is obvious that there can be no real and correlative responsibility for the consequences of any imperfect management. It is said that the railway company did not object to the order for a manager. This may well be so; but in the view I take of the case, the order would be improper, even if made on the express agreement and request of the company."

For English cases showing difference between managers and receivers of railroads, and the rules governing English courts in appointing managers, etc., see Edwards *v.* Standard Rolling Stock Syndicate, 41 Wkly. Rep. 343; Peck *v.* Trinsmaran Iron Co. (1876), 2 Ch. Div. 115; Truman & Co. *v.* Redgrave (1881), 18 Ch. Div. 547; Makins *v.* Percy Ibotson & Son (1891), 1 Ch. 313; Boyle *v.* Bettws Llantwit Colliery Co. (1876), 2 Ch. Div. 726; Morton, Rose, & Co. *v.* Barbadoes Water Supply Co., 37 Sol. J. 729; Whitley *v.* Challis (1892), 1 Ch. 64; rules governing the court in its management of the property: Day *v.* Sykes, Walker, & Co. (1886), 55 L. T. Rep. 763; Securities Investment Corporation *v.* Brighton Alhambra (1893), 68 L. T. Rep. 249.

This distinction between a receiver and a manager seems to have been ignored in this country, except in Langdon *v.* Vermont & Canada R. Co. (1882), 54 Vt. 593, 605, where Judge Redfield took the same view as Sir George Jessel and Lord Cairns.

A receiver has often been called by the judges the "hand" of the court which appoints him, and this term indicates, by way of analogy, with reasonable precision the character of his office. A controlling authority is vested in the court itself. The receiver is merely the agent through whom that authority is exercised.

§ 571. **Receiver appointed for Benefit of Parties interested.** — The appointment of the receiver is made for the benefit of all the parties in interest, and not for the advantage of plaintiff or defendants only.[1]

He has no personal interest whatever in the distribution of the funds, possession of which he obtains as receiver. When the distribution is made, it is for the various parties concerned to contest it, if they so desire.[2]

No preferences are to be shown by him, no practices tolerated that will give an advantage to one class of creditors to the detriment of another class; but the whole business must be managed on a basis of the broadest equity. A receiver should not become a partisan in favor of any particular interest, nor administer his trust at the expense, or to the prejudice, of any interests.[3]

But it is not improper for a receiver to advise, aid, and encourage reorganization schemes which offer the largest measure of protection to the various interests connected with or concerned in the property and assets in his possession.[4]

So also a receiver may without impropriety act as the selling agent of the mortgage trustees.[5]

As a receiver is under the duty of protecting the interest of the mortgagor company, a bondholder who is proceeding to foreclose his lien some years after the commencement of the receivership cannot object to an answer by the receiver which goes to the validity of the lien, or the consideration of the debt secured thereby. It is immaterial in such a case that the receiver has so far discharged his trust that he deems it safe to allow the complainant, who had become owner of all the claims against the company, to take charge of the railroad and all the corporate

[1] Williamson *v.* New Albany, etc. R. Co. (1857), 1 Biss. 198, 205; Herring *v.* New York, L. E. & W. R. Co. (1887), 105 N. Y. 340; s. c. 12 N. E. Rep. 763; Libby *v.* Rosekrans (1869), 55 Barb. 202; Davis *v.* Gray (1872), 16 Wall. 203; Central Trust Co. *v.* Wabash, St. L. & Pac. Ry. Co. (1891), 46 Fed. Rep. 26; s. c. 46 Am. & Eng. R. R. Cas. 301.

[2] Hinckley *v.* Railroad Co. (1879), 100 U. S. 153, 156.

[3] Clark *v.* Central Railroad & Bkg. Co. (1893), 66 Fed. Rep. 16.

[4] Clark *v.* Central Railroad & Bkg. Co. (1893), 66 Fed. Rep. 16. See also chapter on reorganization.

[5] Fowler *v.* Jarvis-Conklin Mortgage Co. (1894), 63 Fed. Rep. 888.

assets, and has thus relieved himself of all trust property, so far as was possible.[1]

In a New Jersey case it appeared that the receiver of a railroad had so far discharged his trust as to deem it safe to allow the complainant, who had become the owner of all the claims against the company, to take charge of the railroad, and entered into an agreement with the complainant as to the payment of the costs of the receivership and the receiver's commissions. This was done without aid of the court, and the complainant called for an answer to his bill from the receiver, and, when made, excepted to the answer. The Chancellor held that, as long as the receivership continued, and the corporation was thereby incapacitated from the discharge of its ordinary functions, the court would not prohibit the receiver from setting up any defence to the foreclosure suit, which would be available in the company itself.[2]

§ 572. **Receiver represents Creditors in Litigation.** — A receiver derives his authority from the act of the court appointing him, and not from the act of the parties at whose suggestion or by whose consent he is appointed.[3]

The receiver is to some extent the representative of the creditors for the purpose of binding them by what is done in the course of proceedings in which he appears. Thus it has been held that a motion to dismiss an appeal from an order made in proceedings in intervention will be denied where all the parties thereto, and also the receiver, have been served with notice.[4]

So also a judgment rendered against a receiver by a court of competent jurisdiction is binding upon the interests of the bondholders.[5]

So also the mortgagees and bondholders who are duly made parties to an action in which a receiver is appointed cannot, after acquiescing for several years in the receiver's exercise of the powers conferred upon him by orders made in the course of the proceedings, be heard to dispute or question the propriety of anything which he may do under the authority thus conferred upon him.[6]

[1] *In re* Fifty-four First Mortgage Bonds (1881), 15 S. C. 304; s. c. 9 Am. & Eng. R. R. Cas. 337.

[2] Ryan *v.* Anglesea R. Co. (N. J. Ch., Feb. 16, 1888), 3 Ry. & Corp. L. J. 426.

[3] Railroad Co. *v.* Humphries (1892), 145 U. S. 82, 97; s. c. 12 Sup. Ct. Rep. 787.

[4] Radebaugh *v.* Tacoma & Puyallup R. Co. (1894), 8 Wash. 570; s. c. 36 Pac. Rep. 460.

[5] Turner *v.* Indianapolis, B. & W. R. Co. (1879), 8 Biss. 527.

[6] Woodruff *v.* Erie R. Co. (1883), 93 N. Y. 609; s. c. 16 Am. & Eng. R. R. Cas. 501.

§ 573. **Fiduciary Position of Receivers.** — The fiduciary position of the receiver precludes him from making a personal profit out of the trust property.

Thus a receiver cannot enforce an accounting from those who join with him in a scheme for the purchase of outstanding bonds, with a view to using the same in buying the railroad at the foreclosure sale, where it is shown that the receiver was to, and did, give to the other parties information respecting the bonds possessed by himself alone, and that the fact that the receiver's interest in and connection with such purchases was suppressed at the time of the foreclosure sale. The rule which forbids one charged with an official duty of a fiduciary nature to betray his trust for private gain involves the corollary that he must bear whatever loss may fall upon him through the dishonesty of his confederates.[1]

So also, even if a purchase of the bonds by a company occupying the position of the lessee, and also of receiver and manager of the insolvent road, is made in an emergency to save the property from destruction, and not with any view to personal gain, the receiver cannot, if the property is redeemed, charge against the mortgagor more than the sum actually paid. If the property is not redeemed, and it appears that the purchase was made at the request of the security-holders themselves, the receiver should be allowed to share in the assets *pro rata* with the other holders of like securities.[2]

But it is not fraudulent *per se* for the receiver to supply materials for the repair of the road out of a stock belonging to himself. The court will not disallow an item in his accounts claiming compensation for such supplies unless some specific evidence is given that an excessive price has been charged.[3]

§ 574. **Receiver's Transaction of Business with other Lines.** — The rights and duties of a receiver in charge of a railroad are those of a common carrier. He is bound to afford to all railroad companies whose lines connect with his own equal facilities for the exchange of traffic. It is his own duty to receive from and deliver to other connecting roads both loaded and empty cars. He cannot discriminate against one road by maintaining a policy of non-intercourse with it.[4]

[1] Farley *v.* St. Paul, Minnesota, & Manitoba R. Co. (1882), 4 McCrary, 138.

[2] Langdon *v.* Vermont & Canada R. Co. (1882), 54 Vt. 593; s. c. 11 Am. & Eng. R. R. Cas. 688.

[3] Farmers' Loan & Trust Co. *v.* Central Railroad Co. of Iowa (1881), 8 Fed. Rep. 60.

[4] Beers *v.* Wabash, St. L. & Pac. Ry. Co. (1886), 34 Fed. Rep. 244, 247; s. c. 26 Am. & Eng. R. R. Cas. 441.

Especially is the court bound to discountenance any discrimination when it is expressly forbidden by statute.[1]

§ 575. **Duties and Powers of Receiver as to his Employees generally.**[2] — In nearly all matters pertaining to the operation of a railroad the action of the receiver must necessarily be conclusive.[3] But exceptions to this rule will be made in cases of unusual importance. Thus the employees of the receiver will be permitted to apply to the court for relief from any substantial grievance suffered by them in the operation of the road under the authority of the court.[4]

So the court may, in its discretion, grant employees leave to file a petition directing the receiver to rescind an order reducing their wages.[5]

But unless a receiver abuses his discretion he will not be interfered with by the court in such a matter as fixing the schedules of wages,[6] or the selection and discharge of his employees.[7]

A receiver is not bound by stipulation of the officers of the company respecting the discharge of employees.[8]

A court of equity undoubtedly has the right to restrain its receiver from treating his employees unjustly or oppressively; but no case for interference on this ground is established by proof that the receivers have undertaken to enforce a long-standing rule made by the company, to the effect that no member of a labor organization would be employed after a certain date, the evidence showing clearly that all the employees then in the service of the receivers had, before being employed, whether by the company or the receivers, signed a statement that they were not members of such organization, or that, if they were, they would withdraw therefrom.[9]

Employees of a receiver of a railroad who join in a sympathetic strike, constituting a boycott, absolve their employer from all

[1] Missouri Pac. Ry. Co. *v.* Texas Pac. Ry. Co. (1887), 30 Fed. Rep. 2; Cutting *v.* Florida Ry. & Navigation Co. (1890), 43 Fed. Rep. 747.

[2] As to the power of the court to restrain strikes, see *ante*.

[3] Thomas *v.* Cincinnati, N. O. & T. P. Ry. Co. (1894), 62 Fed. Rep. 669.

[4] Thomas *v.* Cincinnati, N. O. & T. P. R. Co. (1894), 62 Fed. Rep. 17; Continental Trust Co. *v.* Toledo, St. Louis, & K. R. Co. (1894), 59 Fed. Rep. 514; Frank *v.* Denver & Rio Grande Ry. Co. (1885), 23 Fed. Rep. 757; *In re* Doolittle (1885), 23 Fed. Rep. 544; Waterhouse *v.* Comer (1893), 55 Fed. Rep. 149; Farmers' Loan & Trust Co. *v.* Northern Pac. Ry. Co. (1894), 60 Fed. Rep. 803; Ames *v.* Union Pac. Ry. Co. (1894), 62 Fed. Rep. 7.

[5] Thomas *v.* Cincinnati, N. O. & T. P. Ry. Co. (1894), 62 Fed. Rep. 669.

[6] Continental Trust Co. *v.* Toledo, St. Louis, & K. R. Co. (1894), 59 Fed. Rep. 514; Ames *v.* Union Pac. Ry. Co. (1895), 4 Interst. Comm. Rep. 625.

[7] *In re* Seattle, L. S. & E. R. Co. (1894), 61 Fed. Rep. 541.

[8] Ibid.

[9] Platt *v.* Philadelphia & Reading R. Co. (1894), 65 Fed. Rep. 660.

obligations to accord them any preferential right to employment by reason of their past services.[1]

Nor will a court direct its receiver to enter into any contract with the members of a labor organization who hold themselves bound by a rule which is invalid by reason of its being in restraint of commerce.[2]

With a view to an orderly and economical management of the trust property, the receiver of a railroad should adopt and maintain rules and regulations governing the conduct and establishing the wages of all persons in his service ; but if he deems it advisable to make any change in those rules which were observed while the company was operating the road, there should, in the first place, be a hearing before him as to the proposed alterations, and all the employees to be affected thereby should be notified of the proceedings, and given an opportunity to point out to him any inequality there may be in schedules of wages, or any injustice which would result from the regulations. Any matters of difference which may still remain unsettled after such negotiations are to be referred to the court for final determination. If the receiver undertakes to reverse and rearrange the rules, regulations, and schedules without allowing the employees to present their objections to the proposed changes, the court will decline to sustain his action.[3]

He cannot renounce old schedules of wages and adopt new ones on the ground that the old ones were mere executory contracts by which they were not bound, where they do not absolve the men from the duty of continuing to work, but ask that the new schedules be confirmed by the court, and all the employees directed to conform thereto.[4]

Where the employees are faithful and competent, and the wages paid to them are not higher than the wages paid to like employees on other lines, operated under conditions essentially similar, the court will not, against the protest of the employees, approve a reduction of wages proposed by the receiver merely on the ground that the reduction will turn a present operation of the road at a loss into an operation without loss, even though it is shown that new employees may be obtained at the lower rate of wages. "The

[1] Booth *v.* Brown (1894), 62 Fed. Rep. 794. As to boycotts generally, see note to 53 Am. & Eng. R. R. Cas. 325.

[2] Waterhouse *v.* Comer (1893), 55 Fed. Rep. 149 ; s. c. 53 Am. & Eng. R. R. Cas. 329.

[3] Ames *v.* Union Pac. Ry. Co. (1894), 60 Fed. Rep. 674.

Compare United States Trust Co. *v.* Omaha & St. Louis R. Co. (1894), 63 Fed. Rep. 737.

[4] Ames *v.* Union Pac. Ry. Co. (1894), 62 Fed. Rep. 7.

retention of faithful, intelligent, and capable employees is of much more importance than temporary decrease in earnings, or present ability to secure other employees at reduced wages." [1]

An order relative to the wages of employees should be for the benefit of all parties similarly situated, whether belonging to any of the labor organizations applying for it or not.[2]

§ 576. **Receiver's Accounting.**[3] — It is always the duty of the receiver to file his accounts when required by the court, and, whether specially ordered or not, to make a full report, and pass his accounts at least once a year, since in no other way can the parties in the cause be informed as to their rights, or the court act understandingly.[4]

But inasmuch as he is the officer of the court, and neither party is responsible for his misfeasance or malfeasance, if any such exists, the bondholders cannot be delayed in the collection of their debts until the receiver's accounts have been adjusted.[5]

When a report upon a receiver's account is submitted by a master, the duty of the court consists in reviewing the principles and rules adopted by the master in allowing the accounts, rather than in examining the items in detail, or the evidence on which they are founded.[6]

As a general rule, the court will not consider exceptions to the report unless first made before the master; but this rule is subject to the qualification that the court will direct an account to be reformed where it contains manifest errors or charges clearly improper.[7]

Receivers' accounts passed before the master are not subject to re-examination, and are only assailable by a direct proceeding in court alleging error, fraud, mistake, or the like.[8]

Like other trustees, the receiver must keep the funds in his charge entirely separate and distinct from his individual funds. Any breach of this rule will be at his own peril. Thus a receiver was charged with interest on a sum withdrawn by him from the

[1] United States Trust Co. *v.* Omaha & St. Louis R. Co. (1894), 63 Fed. Rep. 737.

[2] Ames *v.* Union Pac. Ry. Co. (1895), 4 Interst. Comm. Rep. 625.

[3] See generally High on Rec., ch. xix.

[4] High on Rec., § 802.

[5] Milwaukee & Minnesota R. Co. *v.* Soutter (1864), 2 Wall. 510.

[6] Cowdrey *v.* Railroad Co. (1870), 1 Woods, 331.

[7] Ibid.

[8] Farmers' Loan & Trust Co. *v.* Central Railroad Co. of Iowa (1880), 1 McCrary, 352. For a case in which an order of the court requiring receivers to account before a master was construed as meaning that accounts presented already by any of the receivers need not be presented again, see Farmers' Loan & Trust Co. *v.* Central Railroad Co. of Iowa (1880), 2 Fed. Rep. 751

bank in which the trust funds were on deposit, and placed in another bank, where he declined to explain the transaction on his examination before the master to whom the matter was referred.[1]

A statutory receiver appointed in a suit to enforce the lien of the State cannot escape any accounting demanded by the stockholders by showing that the judgment creditors will absorb the fund, or that he is authorized by law to report to the governor, and that the latter was satisfied with his report. But where it appears that such stockholders have in no way been injured by the generality of the statements of the account, and the failure to file vouchers in the Executive Department, and there is no other showing of false or fraudulent conduct, a court of equity will not, for the purpose of merely satisfying the desire of the complainants for information, require the receiver to account more in detail, and file his vouchers, after they have been foreclosed of their interest by the sale.[2]

A receiver cannot be called to an account in any other court than that which appointed him.[3] (As to what expenditures the receiver will be allowed in passing his accounts, see *post.*)

§ 577. **Receivers asking Advice from Court.** — Receivers can, by applying to the court, obtain general advice and instructions, and, in special cases, particular advice and instructions as to their operation of a railroad. If there are parties in interest, and they have their days in court, the advice may be decisive. But if the matter is *ex parte*, the value of the advice depends largely upon the information and ability of the judge, and is probably binding only on the receivers, for the judge may change his mind on hearing a full argument.[4]

A receiver should always refer to the court (or a master appointed on that behalf, if there is such an official) for advice and authority in any matter of importance which may involve a considerable outlay of money.[5]

[1] Hinckley *v.* Railroad Co. (1879), 100 U. S. 153.

[2] Lafayette Co. *v.* Neely (1884), 21 Fed. Rep. 738; s. c. 17 Am. & Eng. R. R. Cas. 242.

[3] Conkling *v.* Butler (1865), 4 Biss. 22.

[4] Missouri Pac. Ry. Co. *v.* Tex. Pac. Ry. Co. (1887), 31 Fed. Rep. 862; s. c. 2 Ry. & Corp. L. J. 424. In that case the receivers asked for instructions as to the meaning of the "long haul" clauses of the Internal Commerce Act, and Judge Pardee contented himself with referring them to a decision by the commission, which he deemed to be sufficiently explicit to enable a traffic manager to protect himself against any serious complaint of unlawful discrimination.

[5] Cowdrey *v* Railroad Co. 1870), 1 Woods, 331.

A federal court should not order its receiver to disregard a State law regulating freight and passenger traffic, while its validity is still *sub judice*. Under such circumstances it is proper to instruct him to accept the rates fixed by the statute, so far as he considers them to be an adequate compensation for the service, and reject the rest. No one will then be injured, as the court will have the funds in hand, and allow suits against the receiver for overcharges, and damages will be recoverable, if the constitutionality of the law is sustained.[1]

Article IV. — Actions affecting the Mortgaged Property during the Receivership.

§ 578. **Right of Receiver to maintain Actions.** — The decided weight of authority sustains the rule that, where there has been no enlargement of the powers of a receiver by legislative enactment, they have in general the same rights of action — neither greater nor less — which were possessed by the persons or corporations upon whose estates they administer.[2]

He may therefore maintain an action to determine the validity of the bonds;[3] and he is as much entitled to recover moneys due upon contracts made with the railroad company as with himself.[4]

But a receiver cannot take charge of any proceeding in a foreign jurisdiction by commencing an action, or defending an existing action without the express authority of the appointing court, so as to bind any property in his hands as receiver.[5]

§ 579. **Permission of Court necessary to bring Suit in same Court.** — Suits affecting the disposal of the property cannot be brought in the court which appointed the receiver, unless its permission is first obtained.

Thus, if a receiver is appointed in a suit to foreclose a prior mortgage, subsequent mortgagees being made parties to the same, the latter cannot file bills afterwards to foreclose the equity of redemption subject to their mortgages without leave of the court. The property being *in custodia legis*, the court can, and should, by proper proceedings in the original suit, protect the interest of all

[1] *In re* McElrath, 2 Dill. 460.

[2] Republic Life Ins. Co. *v.* Swigert (1890), 135 Ill. 150; s. c. 25 N. E. Rep. 680; 9 Ry. & Corp. L. J. 22; 32 Am. & Eng. Corp. Cas. 555; High on Rec., § 201.

[3] Hubbell *v.* Syracuse Iron Works (1886), 42 Hun, 182.

[4] Sunflower Oil Co. *v.* Wilson (1892), 142 U. S. 313; s. c. 12 Sup. Ct. Rep. 235; 48 Am. & Eng. R. R. Cas. 664.

[5] Pendleton *v.* Russell (1891), 144 U. S. 640; s. c. 12 Sup. Ct. Rep. 743.

parties, and the prior mortgagee is entitled to the protection of the court against numerous suits and increased costs.[1]

§ 580. **Co-ordinate Courts precluded from entertaining Jurisdiction of Suits affecting Trust Estate.** — The principle that, if two or more courts have concurrent jurisdiction, that which first obtains control of the subject-matter of litigation is entitled to retain it to the conclusion of the others, has been already discussed in its most general aspects. This principle is jealously enforced by courts of equity, which assume control of corporate property through a receiver. After the receiver is fully vested with the possession of the property, any attempt to disturb his possession by proceedings in a co-ordinate court, without obtaining the permission of the court which appointed him, is a contempt of that court.[2]

Whenever in the course of a receivership the court makes an order which the parties consider injurious to their interests, it is their duty to file a motion at once asking the court to cancel or modify it.[3]

Any proceedings which cannot be effectual without assumption of control over the *res* are within the purview of this rule. Property in a receiver's hands, therefore, is not subject to execution;[4] nor to the process for the enforcement of a mechanic's lien;[5] nor to attachment, although the suit in which he was appointed is subsequently dismissed, where before such dismissal another receiver has been appointed, and the property sold under the direction of the court.[6]

So the claim of a party who asserts that the execution of the mortgage was a breach of trust by which the property reverted to

[1] Sutherland *v.* Lake Superior Ship Canal, Railroad, & Iron Co. (1873), 9 N. B. R. 298.

[2] De Visser *v.* Blackstone (1868), 6 Blatch. 235.

[3] United States Trust Co. *v.* Wabash Western Ry. Co. (1893), 150 U. S. 287; s. c. 14 Sup. Ct. Rep. 86, where the rule was applied against the trustees under a divisional mortgage on a line leased to the company at whose instance the receiver was appointed, inasmuch as they failed to object to an order made with respect to the payment of preferential debts before the rentals of the leased line.

[4] Robinson *v.* Atlantic & Great Western Ry. Co. (1870), 66 Pa. St. 160; Rankine *v.* Elliott (1857), 16 N. Y. 377. Under the Revised Statutes of New York, which authorize the court to restrain by injunction all proceedings at law by any creditor against a corporation after its property has been placed in the hands of a receiver, it has been held that a creditor who has not joined in the application for a receiver may be enjoined from prosecuting an action against a stockholder for the amount of his unpaid subscription to the capital stock. Otherwise the creditor would obtain a preference over other creditors in direct violation of the spirit of the provision of the act.

[5] De Visser *v.* Blackstone (1868), 6 Blatch. 235.

[5] Texas Trunk Ry. Co. *v.* Lewis (1891), 81 Tex. 1; s. c. 16 S. W. Rep. 647.

him, is a claim which must be prosecuted in the court where the receiver was appointed.[1]

To be entitled to the protection of the court, it is not necessary that the property should actually have been reduced to possession by the company at the time the receiver assumes control. For this reason money due to the company cannot be garnisheed in the hands of the debtor without the permission of the court.[2]

Where the possession of a federal court through its receiver can be traced back through several prior receivers to a time antedating the appointment of a receiver by a State court, the federal court will not surrender the trust property to the latter, though the last of the successive receivers was appointed after the one in the State court.[3]

§ 581. **Principle precluding such Interference recognized by Coordinate Courts.** — This right of the court which first obtains jurisdiction to retain it for all purposes imposes on other courts a correlative duty not to interfere with that jurisdiction. A coördinate court in which a second suit is brought upon the same matter should, upon being advised of the pendency of the first suit, dismiss the case, and, if the receiver has been appointed, discharge him, leaving the tribunal which has first acquired jurisdiction to adjudicate between the parties.[4]

A federal court will not entertain a bill against the stockholders of an insolvent corporation for a fraudulent misappropriation of a part of the assets, the concern being at the time when the suit is instituted in the hands of a receiver appointed by the State court.[5]

So a petition to have the judgment of a State court establishing a mechanic's lien declared a paramount lien on the property in the hands of a receiver appointed by a federal court will not be entertained by the latter court where the petitioner obtained his judgment after such appointment, even though the action in the State court may have been begun before the appointment.[6]

[1] Union Mutual Life Ins. Co. *v.* University of Chicago (1881), 6 Fed. Rep. 442.

[2] Richards *v.* People (1876), 81 Ill. 551; Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush (Ky.), 673. The extent to which actual caption of the property is necessary to confer on a court exclusive jurisdiction is discussed in the chapter on jurisdiction.

[3] Central Trust Co. *v.* Chattanooga R. & C. R. Co. (1894), 62 Fed. Rep. 950.

[4] Keep *v.* Michigan R. Co. (1873), 6 Chicago L. News, 101.

[5] Hamilton *v.* Chouteau (1881), 2 McCrary, 509.

[6] Blair *v.* St. Louis, H. & K. R. Co. (1885), 25 Fed. Rep. 2. "The parties," it was said, "preferred to proceed in the State court, without the leave of this court, and they must lie in the bed which they have made." S. P. De Visser *v.* Blackstone (1868), 6 Blatch. 235.

Nor will a federal court take cognizance of a foreclosure suit involving property which has already passed into the hands of a receiver appointed in a similar suit in a State court.[1]

The same principle is applicable where the second suit is brought in a State court, after a receiver has been appointed in a federal court. Under such circumstances, it is immaterial whether the lien which the receiver was appointed to enforce was prior or subsequent to that sought to be enforced in the second court.[2]

Provided the second court is one of merely concurrent jurisdiction for the purposes of the application made to it, it will not assume any greater power to interfere with the pending suit for the reason that it is an appellate court as well, and may therefore ultimately be called upon to review the proceedings in the first court.[3]

Fractions of a day may be taken into account in determining the priority of the appointments of receivers.[4]

Whether the second court defers to the principle of non-interference or not the possession of the receiver cannot, in any case, be affected by proceedings taken in another court than that which appointed him.[5]

§ 582. **Co-ordinate Court will not appoint Receiver where Property is already under Control of Receiver.** — That a receiver will not be appointed to administer property already in charge of a receiver duly appointed by a court of concurrent jurisdiction is a rule to which there is no exception.[6]

The fact that the receiver appointed by the sister court is not doing his duty is not a sufficient reason for departing from this rule; for one who has a complaint against such a receiver may, and must, appeal to the court which appointed him.[7]

Nor will such application be entertained upon the ground that the complainant raises questions not raised in the previous suit.[8]

[1] Hammock *v.* Farmers' Loan & Trust Co. (1881), 13 Fed. Rep. 189.

[2] Milwaukee & Minnesota R. Co. *v.* Milwaukee & Western R. Co. (1865), 20 Wis. 165.

[3] People, *ex rel.*, etc. *v.* McLane (1882), 62 Cal. 616. There the Supreme Court of California, which has concurrent powers with the Superior Courts as to the issue of writs of *mandamus*, declined to grant one to compel a receiver to operate the road, holding that there was a plain, speedy, and adequate remedy in the court in which the receiver was appointed.

[4] East Tenn., V. & G. R. Co. *v.* Atlanta & Florida R. Co. (1892), 49 Fed. Rep. 608.

[5] Russell *v.* Texas & Pac. Ry. Co. (1887), 68 Tex. 646; s. c. 5 S. W. Rep. 686.

[6] Blake *v.* Alabama & Chattanooga R. Co. (1871), 6 N. B. R. 331.

[7] Alabama & Chattanooga R. Co. *v.* Jones (1872), 7 N. B. R. 145.

[8] Alabama & Chattanooga R. Co. *v.* Jones (1872), 7 N. B. R. 145. "This court," said Woods, J., "may pass upon questions not raised in the other courts, even between the same parties and relating to the same subject-matter, but no case can be found authorizing this court to interfere with property in the possession of other courts of concurrent jurisdiction."

Still less can one court entertain a direct application for the removal of a réceiver appointed by another.[1]

The cases in which receivers are appointed in ancillary proceedings rest, of course, upon a different principle. (See below.)

§ 583. **This Rule not applicable where Prior Appointment was a Nullity.** — If the appointment of a receiver was for any reason a nullity, it will be no bar to the subsequent appointment of a receiver by a co-ordinate court.[2]

§ 584. **Assignee in Bankruptcy cannot dispossess Receiver appointed by a State Court,** unless he first discharges the mortgage lien. To allow him to do so would result in depriving the mortgagees of a vested right.[3]

The only circumstances under which the possession of such a receiver can be interfered with is where his title is subject to impeachment for some cause within the provisions of the Bankruptcy Act.[4]

As to the somewhat analogous rules prevailing in the English courts respecting the official liquidator and a receiver, see Chap. XXVI. (appointment of receivers in same court).

§ 585. **Suits affecting Property maintainable in other Courts, if his Possession will not be interfered with.** — The mere fact that the property of a railroad company is being administered upon in proceedings taken in a State court does not prevent citizens of the State from applying to the federal court to establish their claims and obtain relief, if entitled to it.[5]

[1] Young *v.* Montgomery & Eufaula R. Co. (1875), 2 Woods, 606.

[2] Hammock *v.* Loan & T. Co. (1881), 105 U. S. 77; Owens *v.* Ohio Central R. Co. (1884), 20 Fed. Rep. 10.

[3] Davis *v.* Railroad Co. (1873), 1 Woods, 661. The court said. "The rights which supervene upon a mortgage or other specific lien accompanied with possession before proceedings in bankruptcy are very different from those arising from proceedings in State courts in cases of general insolvency. A mere insolvent proceeding, or a proceeding of that nature, and possession of the bankrupt property taken in pursuance thereof, is antagonistical and repugnant to the bankruptcy law, and will be avoided by regular proceedings in bankruptcy. But a proceeding to enforce a mortgage or other specific lien involves the rights of property and possession in pursuance thereof legally or judicially taken before proceedings. Hence the action of the bankrupt court in this case in taking the property in question out of the hands of the receiver was unwarranted and illegal."

[4] Alden *v.* Boston, Hartford, & Erie R. Co. (1871), 5 N. B. R. 230. In this case an injunction directed against the receivers was so far modified as to allow them to enter upon the discharge of their duties.

[5] Griswold *v.* Central Vermont R. Co. (1881), 9 Fed. Rep. 797. There the facts were as follows: Some of the defendants sued with the company, together with other persons, had been appointed receivers of various roads in a cause pending between the defendant company and the holders of its bonds in a State court. While those persons were thus in possession, an agreement was made between the parties and embodied in a decree of the

Hence, as a decree of foreclosure merely cuts off the mortgagor's equity of redemption, a bondholder acting in behalf of his co-bondholders may sustain a bill for foreclosure and the removal of the trustees in a federal court, although these trustees have already commenced a suit to foreclose another mortgage on the same property, and have obtained the appointment of a receiver.[1]

So, although a receiver of the property may have been appointed in a State court, and a reorganized company placed in possession, a bondholder who has not come into the reorganization scheme may maintain a bill against the mortgagor company and its successor for an accounting as to the income. The decree sought in such a proceeding is virtually a personal judgment for a sum of

court, whereby those in possession and their successors were continued in possession, and the cause kept in court, with liberty to any party to apply to the court for further orders. The loans, the repayment of which was sought in the action, were subsequently authorized, and, as a part of the decrees under which they were issued, it was provided that, upon default of principal or interest, the creditors might apply to the courts for aid in realizing their securities. These facts were held not to show the retention of that exclusive control of the railroad property by a State court which a federal court is bound to respect. Judge Wheeler said: "The jurisdiction of courts is given by the law and not by the parties, and can neither be conferred nor taken away by their mere consent or agreement. If the conditions prescribed by the law for jurisdiction exist, the jurisdiction exists, the conditions prescribed for giving this court jurisdiction of the parties exist, and jurisdiction of the case must follow, unless the subject is out of reach. Neither by the terms of the securities, as set forth in the bill, nor as shown in the plea, nor by the conditions of the proceedings, was anything to be done by the court, before the defendants could carry out their obligation to set apart the earnings of the rolling-stock as agreed, and apply them to the satisfaction of these notes. They were at liberty to do it, and, so far as appears, were bound to do it. If there was a failure, the holders of the notes would have a right to apply to the courts of the land for relief, and they would not be deprived of the right to apply to any one court because they had the right to apply to another. Those which were provided were provided for the purpose of giving the right to apply to them. There is nothing to prevent applying to this court, unless it may be that, as is argued, the property is in the course of administration of the State court. It is, however, well settled that the fact that the property is being administered in State proceedings does not prevent citizens of other States from proceeding in the Circuit Courts of the United States to establish their claims and obtain relief if entitled to it."

[1] Mercantile Trust Co. *v.* Lamoille Valley R. Co. (1879), 16 Blatch. 324. The court did not question the general principle that a court which has acquired jurisdiction by proceedings involving the possession of specific property cannot be disturbed in that possession while the proceedings which involve the possession are pending, but held that any relief which the court can give without infringing that principle was within the scope of its powers. Such a course would not, it was held, violate, either in letter or in spirit, the United States statute (Rev. Stat. 720) which prohibits a federal court from enjoining proceedings in a State court. Nor would there be any danger of a conflict between the two courts or their officers, if the relief was moulded with due respect to the possession of the State.

money against the corporation, and does not interfere with the possession of the receiver.[1]

So a suit for an accounting may be maintained in a federal court against parties who have been acting as receivers under an appointment by a State court, where it is apparent that the accounting relates to a period subsequent to the time when the receivership had come to a close.[2]

The usual injunction in cases of a receivership, by which interference with the trust property is restrained, may be modified so far as to allow a creditor to enforce a judgment against any property which may have been attached before the receiver's appointment.[3]

§ 586. **Suits affecting Property after Termination of the Receivership.** — The termination of the receivership, whether by a formal decree or by the acts of the parties,[4] will divest the court which appointed the receiver of its exclusive jurisdiction of litigation affecting the property.[5]

But the court not infrequently reserves jurisdiction after the receiver is discharged for the purpose of facilitating the enforcement of debts and liabilities incurred by the receiver. In that case suits to enforce unsatisfied claims against the receiver, which, if established, will constitute liens upon the property, are to be prosecuted against the property as proceedings *in rem*, upon proper notice to the purchaser, and not against the receiver.[6]

If there is no reservation of jurisdiction in regard to such suits, the court cannot, after the end of the term during which the order of discharge was made, alter or suspend that order, and so regain jurisdiction of the property as to enable a claim for injuries received during the receivership to be prosecuted against the discharged receiver.[7]

Ordinarily, it is only after the actual completion of the sale and the final conveyance of the property to the purchasers that the court loses its exclusive power to manage the property.[8]

If a receiver is illegally deprived of his possession of the prop-

[1] Brooks *v.* Vermont Central R. Co. (1884), 22 Fed. Rep. 211.

[2] Andrews *v.* Smith (1881), 5 Fed. Rep. 833.

[3] Woerishoffer *v.* North River Construction Co. (1885), 99 N. Y. 398; s. c. 2 N. E. Rep. 47.

[4] Mobile & Ohio R. Co. *v.* Davis (1884), 62 Miss. 271.

[5] Andrews *v.* Smith (1881), 5 Fed. Rep. 833.

[6] Farmers' Loan & Trust Co. *v.* Central Railroad Co. of Iowa (1881), 2 McCrary, 181.

[7] Davis *v.* Duncan (1884), 19 Fed. Rep. 477. See also chapter on liability of receivers.

[8] Vilas *v.* Page (1887), 106 N. Y. 439; s. c. 13 N. E. Rep. 743.

erty placed in his charge, the court which appointed him is not thereby deprived of its rights to determine what shall be done with that property.[1]

§ 587. **Suits against Receivers generally.**[2] — The possession of a receiver being the possession of the court appointing him, all actions involving a claim upon the corporate property placed in his charge must be prosecuted in that court.[3]

Except in so far as the rule may have been altered by statute, a receiver is not amenable to suit with respect of the property lawfully in his possession, either in the appointing court,[4] or in another without the leave of the appointing court.[5]

This principle is embodied in the statutes of some of the States. See, for example, the Ohio Code, § 256.

A grant of leave to bring suit against a receiver by the court appointing him reserves the right to the receiver to set up any defence he may have, which can be done by plea, answer, or demurrer.[6]

All the defences which would have been available for the company if it has continued to operate the road are available to the receiver, who within the sphere of his functions as manager represents the company. He is, therefore, entitled to claim the benefit of the Statute of Limitations.[7]

Conversely, if the action was originally begun against the company, and the receiver substituted as defendant, the court will

[1] Minnesota Co. *v.* St. Paul Co. (1864), 2 Wall. 609.

[2] For a *résumé* of the law as to actions by and against receivers, see 25 Am. L. Reg. N. S. 289.

[3] Peale *v.* Phipps (1852), 14 How. 368, 372; Beverley *v.* Brooke (1847), 4 Gratt. (Va.) 187.

[4] Fifth National Bank of Pittsburg *v.* Pittsburg & Castle Shannon R. Co. (1880), 1 Fed. Rep. 190, 192. There the court refused to sustain an action of ejectment brought in clear contempt of court, but granted the plaintiff time to institute a new action.

[5] Melendy *v.* Barbour (1884), 78 Va. 544; s. c. 25 Am. & Eng. R. R. Cas. 622; Fort Wayne, Muncie, & Cincinnati R. Co. *v.* Mellett (1883), 92 Ind. 535; 17 Am. & Eng. R. R. Cas. 293; Mass. Mut. Life Ins. *v.* Chicago & A. R. Co. (1880), 13 Fed. Rep. 857, 861; Central Trust Co. *v.* Wabash, St. L. & Pac. R. Co. (1885), 23 Fed. Rep. 858. In the last case the court denied the petition of a stockholder in another corporation to have its receiver made a party to litigation conducted by that stockholder in another jurisdiction, holding that, as to the question involved, viz. the validity of the guaranty of certain bonds, the court itself would settle it, upon its being properly brought before it.

Where a State is divided into judicial districts like those of New York, a motion for leave to sue a receiver cannot be made in one of those districts, while a general order restraining all interference with the receiver is in force; the general order must first be vacated or modified. Wilkinson *v.* North River Construction Co. (1880), 66 How. Pr. 423.

[6] Davis *v.* Duncan (1884), 19 Fed. Rep. 477, 483.

[7] Bartlett *v.* Keim (1888), 50 N. J. L. 260; s. c. 13 Atl. Rep. 7.

restrain him from setting up the Statute of Limitations as a defence where the claim was not outlawed when the proceedings were instituted.[1]

In an action against a receiver, an order of court appointing the receiver is admissible in evidence where the fact of such appointment is put in issue by the pleadings, without the permission of the court which appointed him.[2]

A court of the United States will not permit its receiver to do any unlawful act, nor any act which amounts to violence or a breach of the peace; and when such act shall first come to the knowledge of the court, and at the first opportunity, regardless of any technical pleading, will make such order as provides for full restitution, and will not permit its receiver to continue the unlawful act, nor obtain any advantage thereby. The court, in such case, properly holds that its officer and receiver, clothed with power from the court, shall not use that power oppressively nor unlawfully, but that, as such officer, he is under the highest obligation at all times to set an example of obedience to law, and of the pursuit of strictly peaceable methods in his conduct.[3]

Where a railway company controlling a system of leased roads covered by mortgages, and the leases of which are for a rental to cover interest on their bonds, has executed a mortgage on its system of roads, and the mortgage is being foreclosed, it is not proper to allow the receiver to disaffirm these contracts of lease on the ground of deficiency of the income of the different roads, when shown that the latter are important as feeders of the main line.[4]

§ 588. **Rule as to Suits for Damages.** — The general prohibitory rule stated in the last section is applicable not only to cases in which the plaintiff seeks to establish a claim to a specific portion of the property in the receiver's hands, but also to an action to

1 Lehigh Coal & Navigation Co. *v.* Central R. Co. (1887), 42 N. J. Eq. 591; s. c. 8 Atl. Rep. 649. Compare Texas & Pacific Ry. Co. *v.* Huffman (1892), 83 Tex. 286; s. c. 18 S. W. Rep. 741.

2 Allen *v.* Central R. Co. (1876), 42 Iowa, 683.

3 Clark, D. J., in Chattanooga Terminal Ry. Co. *v.* Felton (1895), 69 Fed. Rep. 273, 284, in which case the receiver of the court had, by his employees, entered upon the right of way of another railway company, removed certain of its switches and made connections between his road and other points to the disadvantage of the other company. The court issued against him a prohibitory injunction, and a mandatory injunction to restore the switches of the other company to the condition they were in when he removed them.

4 Mercantile Trust Co. *v.* St. Louis & S. F. Ry. Co. (1896), 71 Fed. Rep. 601. The court distinguished the cases of Quincy, M. & P. R. Co. *v.* Humphreys (1891), 145 U. S. 82; s. c. 12 Sup. Ct. Rep. 787; and St. Joseph & St. Louis R. Co. *v.* Humphreys, 145 U. S. 145; s. c. 12 Sup. Ct. Rep. 795.

recover damages for injuries resulting from the operation of the road. Such an action is virtually one the purpose of which was, and the effect of which might be, to take the property of the trust from the receiver's hands, and to apply it to the payment of the plaintiff's claim, without regard to the rights of other creditors or the orders of the court which is administering the trust property.[1]

The objection to the power of any other court than the one appointing him to entertain a suit on this ground against a receiver may be taken by a plea to the jurisdiction.[2]

§ 589. **The Proper Procedure to enforce Claims against Property in Receiver's Hands**, under the ordinary rules of equity practice, where parties have claims against funds in the hands of a receiver,

[1] Barton *v.* Barbour (1881), 104 U. S. 126. To the same effect see Davis *v.* Gray (1872), 16 Wall. 203; Meara's Admr. *v.* Holbrook (1870), 20 Ohio St. 137; De Graffenied *v.* Brunswick & Albany R. Co. (1876), 57 Ga. 22; Thompson *v.* Scott (1876) 4 Dill. 508; s. c. 3 Cent. L. J. 737; Kennedy *v.* I. C. & L. R. Co. (1880), 3 Fed. Rep. 97; Rogers *v.* Mobile & Ohio R. R. Co. (Tenn., 1883), 12 Am. & Eng. R. R. Cas. 442; s. c. 16 Rep. 536; and the note to High on Rec., § 254.

[2] Barton *v.* Barbour (1881), 104 U. S. 126. Justice Miller dissented, adopting the theory of Kinney *v.* Crocker, 18 Wis. 74, which holds that in such cases "it is not a question of jurisdiction in the courts of law, but only a question whether equity will exercise its own acknowledged jurisdiction of restraining suits at law under such circumstances, and dispose of the matter involved, the failure of the plaintiff to obtain leave to bring suit merely involving the consequence that he thereby renders himself liable to have the proceedings arrested by an injunction." See, generally, High on Rec., § 254 *a*, where numerous cases are cited showing that the rule laid down by the Supreme Court of the United States is not sanctioned by all courts. A lengthy criticism of the authorities will also be found in Lyman *v.* Central Vermont R. Co. (1886), 59 Vt. 167, where the doctrine of Barton *v.* Barbour is repudiated. The court, referring to the ruling in Palys *v.* Jewett (1880), 32 N. J. Eq. 302, that the court which appoints a receiver will in a proper case grant leave to sue him, not *ex gratia*, but *ex debito justitiæ*, draws the inference that "a rule requiring the plaintiff to go through the meaningless ceremony of applying for a privilege that he already by right possesses, to a court powerless in itself to give him relief in the premises, *has* no substantial ground to rest upon." This reasoning is not altogether conclusive, for there would appear to be equally strong objections to admitting the propriety of a course which places a court in the incongruous and not very dignified position of rendering a judgment which it is absolutely powerless to enforce without the consent of the court appointing the receiver. As leave either to prosecute the claim in the first instance, or to enforce it after a favorable termination of the suit, must be obtained from the appointing court, it is not so irrational as the critics of Barton *v.* Barbour declare to maintain that this leave should be given before, rather than after, the proceedings in the court of law. It must be admitted, however, that as a matter of practical convenience to suitors, it is advisable that the interference of the appointing court should be limited to the preventive functions of seeing that the trust estate is not impaired by the payment of unwarrantable claims. From this point of view legislation of the same character as that which now permits claimants to sue the receivers of a federal court without first obtaining leave from that court is entirely proper. (See § 594, *post.*)

is to bring their demands into the appointing court, which will direct him to be examined *pro interesse suo* before the master. If upon auditing the claim the court finds it to be a just one, it will direct the receiver to pay it without litigation; but if the court finds the claim to be a doubtful one, it will give the claimant leave to prosecute it before some competent court, consulting herein the convenience of parties, and exercising a judicial discretion.[1]

To assist it in coming to a correct conclusion as to disputed facts, the court may, in its discretion, call in a jury, this being the regular course where the action involves a claim for damages. But, apart from statute, the court is not compelled to resort to a trial by jury.[2]

The assistance of a master may be invoked, or such other steps be taken, for a judicial ascertainment of the facts as may be deemed most appropriate to the particular case.[3]

A master's report upon the liability of receivers in cases ordinarily triable by a jury will not be set aside by the court on an issue of fact, unless the testimony on which the finding is based is of such a character as to produce a firm conviction in the minds of the court that the finding is erroneous.[4]

It was strenuously contended in one noted case that the doctrine by which the person desiring to establish a demand against a receiver is precluded from bringing an action against him without the permission of the court which appointed him may sometimes operate so as to deprive the claimant of his constitutional right of trial by jury. This view did not prevail with the majority of the Supreme Court of the United States. It was pointed out that this right, considered as an absolute one, does not extend to cases of equity jurisdiction; and the practice of the court in regard to issues of fact in patent and bankruptcy cases was specially referred to as an illustration of the rule that, in the time of certain classes of issues, a court of equity had jurisdiction to try them according to its own course of practice.[5]

[1] Thompson *v.* Scott (1876), 4 Dill. 508; Barton *v.* Barbour (1881), 104 U. S. 126; Parker *v.* Browning (1840), 8 Paige Ch. (N. Y.) 388.

[2] Duncan *v.* Atlantic, Mississippi, & Ohio R. Co. (1880), 4 Hughes, 125.

[3] Kennedy *v.* I. C. & P. R. Co. (1880), 3 Fed. Rep. 105, following Davis *v.* Gray (1872), 16 Wall. 203.

[4] Central Trust Co. *v.* Tex. & St. Louis R. Co. (1887), 32 Fed. Rep. 448, 450; Missouri Pac. R. Co. *v.* Tex. Pac. R. Co. (1888), 33 Fed. Rep. 803.

[5] Barton *v.* Barbour (1881), 104 U. S. 126. Mr. Justice Miller expressed his dissent as follows: "I know of no principle, nor of any precedent, whereby a court of law, having before it a cause of action of which that court has jurisdiction, and a defendant charged in regard to his own act, also within the jurisdiction, is bound, or is even at liberty, to deny

By the general law one injured by a railroad operated by a receiver is empowered to sue a receiver of a federal court, and he has a right to prosecute the suit until by its final act the court controlling the receivership shall have put an end to his liability as such. So long as that court controls the receiver and funds in his hands, it may provide for the payment of liabilities incurred by him; and so long as it may do this, it cannot be said that his liability to suitors has ended. It is the judgment finally discharging the receiver that protects him against the judgment of other courts.[1]

Where a person, under the provisions of the act of Congress of March 3, 1887, brings a suit, without leave of the court appointing a receiver of a railroad company, against the receiver in the State court for damages for personal injuries caused by the negligence of the receiver's employees, and has a judgment, notwithstanding the case is tried by the court and not by a jury, a jury not having been demanded by either party, the judgment is conclusive against the receiver as to the amount of damages.[2]

Service of summons in an action for injuries to property on an agent of receivers of a railroad company has been held not to be justified by the statute of Alabama (Acts 1887, February 26) which provides for service of summons where a railroad corporation has permitted its road to be used by any other person or corporation; the statute applies only where use of the road is permitted to a natural person or another corporation, and has no application where possession is given to receivers.[3]

If it is once shown that the case is one of equity cognizance, the trial of questions involved in it belonged to the court itself, no matter what might be their importance or complexity. The right not being an absolute one, the propriety of trying actions against the receiver, with or without a jury, was necessarily a matter to be decided by the court in the exercise of its discretion.

The doctrine of Barton *v.* Barbour is perhaps not intended to

the party his lawful right to a trial of his cause because the defendant is receiver of some other court, and to leave the suitor to that court for remedy, where it is known that some of the most important guaranties of the trial to which he is entitled, and which are appropriate to the nature of his case, will be denied him. Whatever courts of equity may have done to protect their receivers, and may do to protect the fund in their hands, it is no part of the duty of courts of law to deny to suitors properly before them the trial of their rights which justice requires, and which the constitution and law guaranty."

[1] Houston & Texas Central Ry. Co. *v.* Strycharski (Tex. Civ. App., 1896), 35 S. W. Rep. 851.

[2] St. Louis S. W. Ry. Co. *v.* Holbrook (1896), 73 Fed. Rep. 112, following Dillingham *v.* Hawk (1892), 9 C. C. A. 101; s. c. 60 Fed. Rep. 494, 495.

[3] *Ex parte* Charles (Ala., 1895), 18 So. Rep. 73.

apply to cases where the question raised is one which the adverse party has an absolute right, under a special provision of a State constitution, to have decided by a jury. In California it has virtually been held that the ordinary rules of equity practice must give way to the peremptory terms of a provision that the amount of compensation to be paid in proceedings in eminent domain shall be assessed by a jury.[1]

Under such circumstances, the power of the court is as much curtailed in this particular class of cases as it has been in Georgia in all classes of cases.[2]

Whether the exclusive *jurisdiction* of the court is also by implication curtailed by such a provision is not so clear, and remains to be judicially settled.

It is admitted on all hands that in cases where the receiver is charged with a tort, "it is more in accordance with the spirit of our institutions to permit the parties complaining to proceed at law, where they may have the benefit of a jury trial, than to attempt to settle their rights by a reference to a master."[3]

The remedy by action is especially proper in a State whose Code confers on a receiver, "under the control of the court, power to bring and defend actions in his own name, as receiver."[4]

Where an action has been brought against a receiver in a common-law court, and a verdict rendered against him, it will be assumed, on appeal, that whatever was necessary to sustain the case stated in the declaration was proved on the trial, and that such leave was granted.[5]

[1] Pacific Ry. Co. *v.* Wade (1891), 91 Cal. 449; s. c. 27 Pac. Rep. 768. There the actual ruling of the court was that the amount to be paid for the joint use of a street-railway track in the hands of a receiver may be determined by the court on a petition, the right of the adverse party to a jury being denied on the ground that such a proceeding did not involve the exercise of the right of eminent domain, where the statute, as in California, made the payment of half the cost of construction the sole condition precedent to obtaining the use of the track.

[2] Clews *v.* First Mortgage Bondholders (1874), 51 Ga. 131.

[3] Parker *v.* Browning (1840), 8 Paige Ch. 388, per Chancellor Walworth. Compare Palys *v.* Jewett (1880), 32 N. J. Eq. 302.

[4] Meara's Admrs. *v.* Holbrook (1870), 20 Ohio St. 137. In this case the action was brought against the receivers, in their capacity as such, by leave of the court, and they entered their appearance pursuant to an order of the court, and defended in their official capacity.

[5] Little *v.* Dusenberry (1884), 46 N. J. L. 614. This was held, in its practical effect, to be merely a statutory method of procuring redress, substantially the same as that under the practice in Courts of Chancery, where it was ordinarily obtained by proceedings *pro interesse suo*. The court, for the same reason, pronounced that there was no merit in the objection that any remedy which the plaintiffs might have could be obtained only by direct application to the court which had control of the receivers, and not by action against them.

§ 590. **Failure to obtain Leave to sue Receiver can be taken Advantage of by him alone.** — Failure to obtain leave to sue a receiver can be taken advantage of by the receiver only, and does not affect the jurisdiction of the court where the receiver waives the requirement.[1]

§ 591. **General License to sue Receiver in other Courts sometimes given.** — A general license to sue the receiver in any tribunal that would be open to the plaintiff, if the controversy had arisen between him and the company, may probably be inserted in the order of appointment.[2]

§ 592. **Claims against Employees of Receiver subject to Exemption Laws of State where the Receiver was appointed.** — Creditors of a receiver's employees will not be allowed to evade the exemption laws of the State where the receiver was appointed by instituting garnishment proceedings in another State into which the railroad extends. No injunction will be issued; the court will merely declare that such claimants will not be allowed to receive from the receiver any wages or funds that may belong to the debtors.[3]

§ 593. **Enforcement of Taxes upon Property in the Hands of Receiver.** — Taxes levied by a State upon property in the hands of a receiver appointed by a federal court can be enforced only by an application to the court itself.[4]

[1] Tobias *v.* Tobias (1895), 51 Ohio St. 519; s. c. 38 N. E. Rep. 317.

[2] Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 260; s. c. 17 Am. & Eng. R. R. Cas. 324.

[3] *In re* Barnard, United States Trust Co. *v.* Omaha & St. Louis R. Co. (1894), 61 Fed. Rep. 531.

As to garnishment of money due from receiver, see note to 26 Lawyers' Rep. Ann. 218.

[4] *In re* Tyler (1893), 149 U. S. 164; s. c. 13 Sup. Ct. Rep. 785, in which the authorities were very fully reviewed by Chief Justice Fuller. This decision lays down a much more rigorous doctrine as to the exclusive nature of the court's control of such suits than some of the earlier cases. In Stevens *v.* New York & Oswego Midl. R. Co. (1875), 13 Blatch. 104, an injunction restraining collectors from executing tax warrants was asked on the ground of irregularities in the assessment. The court refused to interfere, as the warrants were, so far as appeared, regular on their faces, and collectors were acting thereunder in good faith in the discharge of their duty. No question of jurisdiction was raised. In Central Trust Co. *v.* Wabash, St. L. & Pac. R. Co. (1886), 26 Fed. Rep. 11, Judge Brewer laid down the general rule that, as the State in collecting taxes is exercising its sovereign power, there should be no interference with its collection of those taxes in the prescribed and regular methods, even by a court having property in the possession of its receivers, unless it is first charged that the taxes are in some way illegal or oppressive. Accordingly he declined to issue an attachment against the collector. In Central Trust Co. *v.* New York City & Northern R. Co. (1888), 110 N. Y. 250; s. c. 18 N. E. Rep. 92; 13 Cent. Rep. 404, the court merely claimed for the court which is administering the property an alternative right to entertain an application for payment of the taxes through the receiver, the special proceedings prescribed by statute not being exclusive in cases of receivership.

Where an act authorizing the taxation of railroad companies prescribes a certain penalty for a default in payment, a court which is administering the property through a receiver, even if it decides that the provision is not applicable, will see that the State does not suffer, and direct the receiver to pay interest from the time that the tax was in default.[1]

§ 594. **Federal Legislation altering the Former Rules of Equity Courts.** — So far as the federal courts are concerned, the old rule as to suits against receivers has been greatly changed by a recent enactment of Congress,[2] which provides that "every receiver or manager of any property, appointed by any court of the United States, may be sued in respect of any act or transaction of his in carrying on the business connected with such property, without the previous leave of the court in which such receiver or manager was appointed; but such suit shall be subject to the general equity jurisdiction of the court in which such receiver or manager was appointed, so far as the same shall be necessary to the ends of justice." The object of this act has been explained as follows: "This act was intended to correct abuses that had grown up under the old practice, some of which were pointed out before the passage of the act in the opinion of this court in Dow *v.* Railroad Co., 20 Fed. Rep. 260, 267. The act abrogates the old rule on the subject of suing receivers. It is no longer unlawful to sue a receiver appointed by a United States court without leave of the court appointing the receiver. The court now has no discretion to say when its receiver may be sued. The act gives the right without condition or qualification. It is a right not to be nullified, evaded, or abridged. No conditions can be imposed on its exercise. The court must give effect to that act. It has no discretion to do anything else." It was accordingly held that where receivers had been appointed for a railroad in a State through which the road ran, but had removed into another State, suits in the State court against them would be authorized; also that service might be made on their station agents or clerks therein, the receivers taking the place of the railroad company in the operation of the road, and that such service, being a good service on the company, would be good on them.[3]

[1] Ketchum *v.* Pacific R. Co. (1876), 4 Dill. 41.

[2] 25 U. S. Stat. 436, § 3, ch. 866 (March 3, 1887).

[3] Central Trust Co. *v.* St. Louis, A. & T. R. Co. (1889), 40 Fed. Rep. 426, per Caldwell, J. Compare Texas & Ry. Co. *v.* Watts (Tex.), 18 S. W. Rep. 312, where it was held that an order of a federal court requiring claims to be presented before it by intervention was void, as an attempt to destroy the right conferred by the act of Congress.

In a later case the same court had occasion to construe the provision of this act to the effect that when a receiver is sued, the "suit shall be subject to the general equity jurisdiction of the court in which such receiver or manager was appointed, so far as the same shall be necessary to the ends of justice," and explained it as follows: "This clause of the act establishes no new rule, but is merely declaratory of the previously existing laws. The receiver holds the property for the benefit of all persons having any interest in or lien upon it. The road is a unit. Broken into parts, or deprived of its rolling-stock, its value would be greatly impaired. Suits, therefore, which seek to deprive the receiver of the possession of the property, and all process the execution of which would have that effect, are subject to the control of the court appointing the receiver so far as may be necessary to the ends of justice. The marshalling of the assets and the orderly distribution of the fund or property according to the rights and equities of the several parties in interest, is not to be interfered with by the judgment or process of the State court. The judgment of the State court is conclusive as to the amount of the debt, but the time and mode of its payment must be controlled by the court appointing the receiver.[1]

This act applies to any suit which was commenced after the date of its enactment, though the cause of action accrued before that date.[2]

The right to sue in State courts receivers appointed in federal courts, without obtaining leave from the appointing court, can only be exercised with reference to transactions of theirs concerning the management of the estate.[3]

Under the act, the judgment rendered by a State court having jurisdiction of the parties and the subject-matter against a receiver appointed by a State court is as final and conclusive as it is against any other suitor. See case last cited.[4]

§ 595. **Exclusive Control of Receivers of Federal Courts not affected by State Legislation.** — Since a federal court cannot be affected by State legislation, a statute giving one who has recovered judgment against a railroad company controlled by a receiver the right to collect the judgment, by obtaining an order from the

[1] Central Trust Co. *v.* St. Louis A. & T. R. Co. (1890), 41 Fed. Rep. 551, 555.

[2] Texas & Pac. R. Co. *v.* Cox (1892), 145 U. S. 593; s. c. 12 Sup. Ct. Rep. 905.

[3] Hayes *v.* Columbus, L. & M. Ry. Co. (1895), 67 Fed. Rep. 630.

[4] Central Trust Co. *v.* St. Louis, A. & T. R. Co. (1890), 41 Fed. Rep. 551, 555.

State court upon the receiver for its payment out of the current receipts of the railroad, cannot be made applicable to a case where the receiver has been appointed by a federal court. The proper remedy under such circumstances is to obtain leave to sue the receiver, or to apply to the federal court for an order upon the receiver to pay the judgment.[1]

[1] Ohio & Mississippi R. Co. *v.* Fitch (1863), 20 Ind. 498.

CHAPTER XXVIII.

PREFERRED DEBTS.

ARTICLE I. — GENERAL PRINCIPLES.

§ 596. **Introductory.** — In a preceding chapter (XXV.) it has been shown that the overwhelming weight of authority is in favor of the doctrine that the fact of the income's being made specifically subject to the lien of the mortgage does not in any way limit the power of the company, so long as it is rightfully in possession, to use that income, as it may deem expedient, in the conduct of the business. That power, however, is not entirely unrestricted, for the principle is now firmly established in the jurisprudence of this country that a court of equity, when asked to administer the assets of an insolvent railroad corporation for the benefit of the mortgagees, will mould its relief upon the theory that there are certain classes of unsecured creditors which the mortgagor not only may, but must satisfy, before it can rightfully use any portion of the earnings for paying the bonded interest, or for permanent improvements which will augment the value of the *corpus* of the estate, and thus inure to the benefit of the mortgagees.

A court administering the rights of litigants in accord with the principles of law and equity has no inherent right simply by virtue of its judicial authority to displace valid mortgage liens that are fixed upon the property and which is subject to the liens, and require that such liens shall be postponed to claims which were not in existence at the time the mortgage liens were created, or are not based upon some contract or provision of the law which gives them a prior right over the mortgage liens.[1]

A general creditor of an insolvent corporation, by the levy of an attachment prior to a receivership, will not acquire any preference, right, or lien that will deprive the court of the power to equitably apportion the income from the property to claims classed as operating expenses.[2]

[1] Farmers' & Merchants' Nat. Bank *v.* Waco Electric Ry. & Light Co. (Tex. Civ. App., 1896), 36 S. W. Rep. 131.

[2] Ibid.

Where a bondholder of a corporation seeks by a bill to preserve a railroad system from disintegration, etc., to have a receiver appointed for it, if one is appointed and the court takes thereby control of the property, such a receiver will in reality represent the corporation and not the creditors, and his acts will be just such as the corporation itself can do, in the matter of contracting and payment of debts, connected with carrying on its business. And the court may, on their appointment, authorize them, in their discretion, from time to time, to pay the current pay-rolls, vouchers, and supply accounts incurred in the operation of the road prior to their appointment, and to apply funds coming into their hands as the company may have applied them.[1]

And where mortgage trustees afterwards proceed in the same court for the foreclosure of their mortgages, and procure a modification of the order, and have receivers appointed, the court then has power to make a claim for supplies furnished shortly before the first appointment of receivers a lien upon the *corpus* of the property.[2]

[1] New England R. Co. *v.* Carnegie Steel Co. (Lim.), 75 Fed. Rep. 54 (1896).

[2] New England R. Co. *v.* Carnegie Steel Co. (Lim.). 75 Fed. Rep. 54 (1896).

The equitable doctrine is not applicable in a proceeding to distribute the assets of an insolvent corporation under Ga. Code, § 3149 *et seq.*, forbidding the acquisition of any preference after the appointment of a receiver, especially where the mortgagee comes in to make defence only. Central Trust Co. *v.* Thurman (1894), 94 Ga. 735; s. c. 20 S. E. Rep. 141.

In England, so far as is known, no doctrine resembling that discussed in this chapter has ever, apart from statute, been recognized by the courts, except in regard to the payment of wages. According to Lord Denman (in Thomas *v.* Williams, 1 Ad. & El. 690), there had grown up a "humane practice" of paying clerks and servants a full six months' wages out of a bankrupt estate, and this practice was legalized by the Bankruptcy Act of 6 Geo. IV., ch. 16, § 48. A similar doctrine prevailed in Scotland prior to the passage of the Scotch Bankruptcy Act, the debts due to servants for the term running when death or bankruptcy supervened being classed among the "privileged debts" recognized under the doctrine respecting "tacit hypothecs." See Bell's Principles, §§ 1387, 1404. Considering all the exhaustive discussion which has attended the introduction of the rule as to preferential debts in the courts of this country, it is somewhat remarkable that these precedents for at least a portion of the rule, have never been alluded to, so far as is known. See *post.*

The propriety of adopting the doctrine of preferential back claims has, apparently, not been directly discussed in Canada, but in Wallbridge *v.* Farwell, 18 S. C. Can. 1 (1890), Justice Strong used some language which would seem to show a disposition to follow the lead of the courts of this country. In Gooderham *v.* Toronto, etc. Ry. Co., 8 Ont. App. Rep. 685, the "working expenses and outgoings of a railway," for which the receiver was directed to provide before submitting his accounts, and passing in the balance, were held to include working expenses which were not regularly payable in the ordinary course of the business until after his appointment, but not those already in default at the time of the appointment. But the doctrine of the courts of equity in the United States was not alluded to.

Useful articles on the subject of prefer-

§ 597. **Substance of Leading Case, Fosdick v. Schall.** — The leading case on this doctrine is Fosdick *v.* Schall,[1] in which,

ential claims will be found in 6 Southern Law Review, N. S. 535; 12 Am. Law Review, 660; 13 Am. Law Review, 40.

[1] 99 U. S. 235; s. c. 7 Rep. 449 (1879). The principles formulated in this decision had been foreshadowed with more or less distinctness in a few earlier cases, Thus in Clark *v.* Williamsport R. Co. (an unreported case in the Supreme Court of Pennsylvania), Judge Strong (afterwards Associate Justice of the Supreme Court of the United States) declined to accede to the request of some intervening bondholders, who asked him to strike out of an order appointing a receiver a direction to pay all sums "due and maturing" for materials and supplies about the operation of the road, and the amounts "due and maturing" for wages of employees. The conclusion of the learned judge was that, as to the tolls and income, out of which the claims were directed to be paid, the mortgagees had no rights paramount to those possessed by the claimants for wages and for the price of supplies. The mortgagees, it was admitted, were entitled under the mortgage to the income, but only to the *net* income, left after paying current expenses.

In Duncan *v.* Trustees, 9 Am. Ry. Rep. 386; 3 Centr. L. J. 57 (Circuit Court Va., 1876), the court granted a petition for authority to apply the surplus earnings of the road, then in a receiver's hands, to the payment of arrears of wages due before the receiver's appointment. The decison was placed on two grounds. *First,* because "the laws of humanity, the policy and laws of two States, overriding all questions of pecuniary interest in stockholders or bondholders," forbade the relaxation of any means necessary to the maintenance and safe operation of the road; and, *secondly,* because, after default, "while the bondholders stood aloof without asserting their rights to possession, the officers of the road were to be considered *pro tanto* as agents of the bondholders."

In Douglass *v.* Cline (1877), 12 Bush, 608; s. c. 18 Am. Ry. Rep. 273, certain claims of labor and supply creditors were preferred to the mortgage lien, the ground being distinctly taken that the appointment of a receiver was a discretionary exercise of power, and that the bondholders, having elected to avail themselves of the equitable remedy of foreclosure, instead of taking possession of the property, as they were entitled to do, could not be heard to complain that the court, in granting them equitable relief, had imposed conditions as to the payment of the meritorious claims of persons whose services had contributed to the preservation of the property. To ask the court not only to apply the proceeds of the property thus preserved to the payment of the mortgage debt, but also to hold the fund accumulated by the receiver, and refuse to apply any portion of it to paying for services thus resulting to their direct and substantial advantage, was held to be a request incompatible with the maxim, "He who seeks equity must do equity." In this case it would seem from the report that there was no specific pledge of the income, for one link in the chain of the reasoning was that a mortgagee who has no specific pledge of the rents and profits cannot claim them as a legal incident or a legal right growing out of his mortgage. But in view of later decisions this point is immaterial. See the remarks of Justice Harlan in Thomas *v.* Peoria & R. I. R. Co. (Western Car Co., Intervener), (1888), 36 Fed. Rep. 808; s. c. 36 Am. & Eng. R. R. Cas. 381, touching upon this very point.

In Turner *v.* Indianapolis, B. & W. R. Co. (1878), 8 Biss. 315, the court expressed its views in words which indicate that the doctrine had now reached its full development, and was merely awaiting the sanction of the Supreme Court of the United States (which was given the following year in Fosdick *v.* Schall) to claim a definite position in the equity jurisprudence of the federal courts. "The mortgagees have come into court asking it to assume possession of the road to protect their interests. Are the interests of all others, operatives and supply men, who happen to have claims against it at the time to be absolutely ignored in the case of insolvent companies? I think not.

after an exhaustive argument by some of the ablest lawyers in the country, its precise scope was clearly defined. In the opinion written for a unanimous court, Chief Justice Waite said, amongst other things: "We have no doubt that when a Court of Chancery is asked by railroad mortgagees to appoint a receiver of railroad property, pending proceedings for foreclosure, the court, in the exercise of a sound judicial discretion, may, as a condition of issuing the necessary order, impose such terms in reference to the payment from the income during the receivership of outstanding supplies, equipment, or permanent improvement of the property, as may, under the circumstances of the particular case, appear to be reasonable. . . . The business of all railroad companies is done to a greater or less extent on credit. This credit is longer or shorter, as the necessities of the case require; and when companies become embarrassed, it frequently happens that debts for labor, supplies, equipment, and improvements are permitted to accumulate, in order that bonded interest may be paid, and a disastrous foreclosure postponed, if not altogether avoided. In this way the daily and monthly earnings, which ordinarily

The appointment of a receiver is, to a great extent, a matter of discretion in the court, and it has been thought that the court might require the receiver to pay certain of these claims, and even to hold the property subject to them; not as a lien on the road, but in the exercise of the equitable discretion of the court in dealing with property which is of a peculiar character, and under circumstances of which the past history of litigation affords no example or precedent. Railways do not come within the control of the court until after default on the bonds or coupons, and, generally, after absolute insolvency. There are, therefore, when application is made to the court for the appointment of a receiver, in all cases, large balances due to operatives, and for supplies and materials furnished. There are also contracts running with other railways upon which balances are due, and which contracts must often be continued in force to preserve the security of the mortgagees. The receiver takes the road with the benefits accruing from such contracts, and uses any supplies or materials which are on hand and not paid for. It therefore early became a question in this species of litigation what rule should be adopted by the court as to such claims against railway companies."

On the other hand, in Kitchen *v.* Pacific Railroad Co., 4 Centr. L. J. 458, an application for the payment of some back claims was refused, as it was opposed by the bondholders, though some similar claims had previously been paid with their consent.

In Denniston *v.* Chicago, A. & St. L. R. Co. (1864), 4 Biss. 414, an attempt was made by certain supply creditors to obtain the payment of their claims in preference to the bonded debt out of the proceeds of the foreclosure sale, but Judge Drummond declined to make an order to that effect. This case is still good law, except in so far as the rule may have been altered by statutes. See below in this chapter.

In many of the federal courts during the years immediately preceding the rendition of this decision in Fosdick *v.* Schall, it had already grown into a custom to provide for debts, labor and supplies, and the like, when a receiver was appointed, but, apparently, this was usually done with the consent of the bondholders. Such, at least, was the rule adopted by one eminent jurist, Judge Dillon. See 3 Cent. L. J. 636.

should go to pay the daily and monthly expenses, are kept from those to whom in equity they belong, and used to pay the mortgage debt. The income out of which the mortgagee is to be paid is the net income, obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, proper equipment, and useful improvement. Every railroad mortgagee, in accepting his security, impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim upon the income. If, for the convenience of the moment, something is taken from what may not improperly be called the current debt fund, and put into that which belongs to the mortgage creditors, it certainly is not inequitable for the court, when asked by the mortgagees to take possession of the future income and hold it for their benefit, to require, as a condition of such an order, that what is due from the earnings to the current debt shall be paid by the court from the future current receipts before anything derived from that source goes to the mortgagees. In this way the court will only do what, if a receiver should not be appointed, the company ought itself to do. . . . We think, also, that if no such order is made when the receiver is appointed, and it appears in the progress of the cause that bonded interest has been paid, additional equipments provided, or lasting and valuable improvements made out of earnings which ought in equity to have been employed to keep down debts for labor, supplies, and the like, it is within the power of the court to use the income of the receivership to discharge obligations which, but for the diversion of funds, would have been paid in the ordinary course of business. This, not because the creditors to whom such debts are due have in law a lien upon the mortgaged property or the income, but because, in a sense, the officers of the company are trustees of the earnings for the benefit of the different classes of creditors and the stockholders, and, if they give to one class of creditors that which properly belongs to another, the court may, on an adjustment of the accounts, so use the income which comes into its own hands as, if practicable, to restore the parties to their original equitable rights. While ordinarily this power is confined to the appropriation of the income of the receivership, and the proceeds of the moneyed assets that have been taken from the company, cases may arise where equity will require the use of the proceeds of the sale of the mortgaged property in the same way. . . . No fixed and inflexible rule can be laid down for the government of the courts in all cases. Each case will necessarily have its own peculiarities, which must

to a greater or less extent influence the Chancellor, when he comes to act."

The effect of the opinion of Fosdick *v.* Schall has been tersely stated by Judge Hughes to be that " a court may for certain purposes stand in the shoes of the company whose property it has sequestrated, and satisfy equities which the company necessarily contracted for the benefit of all parties interested in keeping the railroad alive and in operation." [1]

§ 598. **Preferred Debts not Liens.** — Preferred debts are not ranked above the bonded interest because they are a lien,[2] but on the ground that the application of the income to debts incurred to keep the road in operation is the paramount duty of the company, and that its failure to perform that duty is inequitable conduct, the results of which a Chancellor is justified in correcting, if he is asked by the mortgagees to sequestrate the income for their benefit by the appointment of a receiver. This theory has been justly characterized as a " new departure." [3]

[1] Atkins *v.* Petersburg Railroad Co. (1879), 3 Hughes, 307; s. c. 2 Fed. Cas. 90, Case No. 604.

[2] See the extract given above from the opinion in Fosdick *v.* Schall. So also in Turner *v.* Indianapolis, B. & W. R. Co. (1876), 8 Biss. 315, the court said: " During the discussions which have taken place on this subject, the allowance of these 'back' claims has been sometimes called a lien, but in point of fact it never has been, nor can it be justly so considered, but, as already stated, is an exercise of the equitable power of the court in the premises." To the same effect are the remarks of the court in Addison *v.* Lewis (1882), 75 Va. 701; s. c. 9 Am. & Eng. R. R. Cas. 702; Union Trust Co. *v.* Walker (1882), 107 U. S. 596.

[3] Williamson *v.* Washington City, Va. Midland, & Great Southern R. Co. (1881), 33 Gratt. 624; s. c. 1 Am. & Eng. R. R. Cas. 498; Addison *v.* Lewis (1882), 75 Va. 701; s. c. 9 Am. & Eng. R. R. Cas. 702.

The view taken by the profession at large as to preferred debts, before the decision in Fosdick *v.* Schall, is perhaps fairly well expressed in the article in 3 Central L. J. 636. Up to the time when that was written, it seems that the payment of these debts had been made with the consent of the bondholders, and the general doctrine as to a special equity, which might be enforced by imposing conditions at the appointment of a receiver, had only been announced in one case, — Douglass *v.* Cline, *supra.*

In one of the earlier cases on the subject, the following theory was propounded as an additional reason for the court's assumption of the right to apply the earnings to back claims: "There is a distinction between the net earnings of a railroad operated by a receiver and the ordinary rents and profits of lands and tenements. The receiver of a line of railways is not the mere passive agent or officer of the court charged with the single duty of preserving the property and collecting the rents, etc. The net earnings of a railway in the hands of a receiver depend very greatly upon his experience and skill as a railway operator, and upon the energy and fidelity he may display in the discharge of his duties. The mortgagees have no claim or lien upon the experience, skill, energy, and fidelity of the court's receiver, who represents the interests as well of the mortgagors or of its creditors." Douglass *v.* Cline (1877), 12 Bush, 608; s. c. 18 Am. Ry. Rep. 273. But this theory is open to the obvious objection that the court does no more than its duty in securing the best possible management for the property which is taken out of the owner's

To allow arrears of wages or other debts for operating expenses to accumulate is not inequitable in any sense in which that term is used in relation to the administration of an insolvent estate by a Court of Chancery. Nor, apart from some statute, has it ever been maintained in regard to any other business than that of a railroad that a debtor is not entitled to favor one or more creditors in the disposition of his income. Least of all has a debtor's right to favor secured creditors ever been denied prior to the decision of Fosdick *v.* Schall.

§ 599. **Superior Equity of Preferred Debts based upon the Character of Railroad Business.** — Such being the general principles governing the rights of the parties in similar cases, the superior equity thus predicated of preferential claims must evidently rest upon some entirely special ground, and the courts have found what they deem an adequate basis for that equity, the peculiar nature of the business conducted by a railroad company.[1]

control. To infer that the performance of that duty can give the court any extraordinary rights as regards the displacement of vested liens is, to say the least, rather a startling proposition.

[1] The unique characteristics of that business have perhaps never been stated with more vigor and clearness than by Judge Caldwell, in the following passage of his opinion in the recent case of Farmers' Loan & Trust Co. *v.* Kansas City, W. & N. W. Ry. Co. (1892), 53 Fed. Rep. 182: —

"Railroads and railroad mortgages are of modern origin. The courts at first failed to distinguish between a mortgage on a railroad and a mortgage on a house and lot, and receivers were appointed without making any provision to pay even the current wages of the employees of the company, or to pay for the most essential supplies, however recently furnished. Experience and observation demonstrated the inequity of this mode of proceeding. Courts of equity were compelled to inquire into the nature of railroad property and railroad mortgages. It was perceived that, as a security for a debt, there was much more analogy between a railroad and a ship than there was between a railroad and a house and lot. It was perceived that railroads performed on land the same offices that ships did on the sea. They are both great and indispensable instruments of commerce. Their chief difference as such instruments is the chemical composition of the elements upon which they are operated. One moves in the water, and the other on iron rails. It is said of ships that they are made to plough the seas, and not to rot at the wharves; and railroads are built to be actually operated in carrying the commerce of the country, and not to rust out. Unless it is kept in operation, a railroad does not fulfil the purpose of its creation, and is comparatively valueless as an instrument of commerce, or for any other purpose, without incurring daily expenses for work, supplies, and materials. These debts are never paid at the time they are contracted. That is impossible from the nature of the business. In the case of solvent companies, the time of payment varies, and it varies with the same company at different times. It is longer or shorter, depending on the financial condition of the company, the length of its line, and other causes. The labor, supplies, and materials are absolutely essential to the operation of the road, and, as a matter of fact, are in most cases furnished on its credit, in the same sense that the supplies of a ship are furnished on the credit of the ship. For these and other like reasons there has been a growing tendency among the courts and legislatures in this country to give such debts of a

It is true that Chief Justice Waite in his opinion in Fosdick *v.* Schall bases the more extreme application of the doctrine, viz. that relating to the restoration of diverted earnings, upon the principles that the directors are "trustees of the stockholders and creditors." But the implied duty of the directors to postpone even the lien creditors to those of the preferred class must, it is plain, be ultimately referred to the existence of some peremptory equity which is recognized for some anterior and distinct reason, apart from the fiduciary position of the directors. The mere fact that they are trustees does not of itself obligate them to pay debts in an unusual way.[1] A similar remark is applicable to the supposed correlative duty of the mortgagees to refuse to be favored at the expense of the preferred creditors, or, if they have been so favored, to acquiesce in the restoration of the diverted funds.[2]

railroad company priority over the lien of a mortgage. It seems probable that the courts will not have to deal with the question on general principles of equity much longer. Some of the States have already passed acts giving all obligations incurred in the construction and operation of a railroad priority over mortgages, and similar statutes will probably soon be passed in other States, unless the practice and decisions of their courts shall render them unnecessary. Undoubtedly, under the operation of these statutes, and the later and sounder practice of a condition of the appointment of a receiver for a railroad, the payment of the class of debts mentioned, the ends of justice have been promoted, and a stop put to some practices which were extremely inequitable and injurious alike to the company, the mortgagee, and the general creditors. It occurs less frequently now than formerly that railroad receivers are appointed, and mortgages foreclosed, leaving unpaid in whole or in part those whose labor and materials built the road and created the security, — for railroad mortgages are sometimes executed before a shovelful of earth has been thrown towards the construction of the road, — or kept it in repair and operation after its construction. When it is known that a misapplication or fraudulent use of the proceeds of the bonds, or the earnings of the road, cannot be visited upon the innocent persons whose labor and materials build the road, or keep it in repair and operation, the mortgagee will see to it that the revenues of the company, derived from these and all other sources, are expended for legitimate purposes. Honesty and economy in railroad building and management will thus be promoted, and the company, the mortgagee, and the public will alike be benefited."

[1] This objection is independent of that which arises from the difficulty, or rather perhaps impossibility, of finding any authorities, apart from those under review, or those which turn upon some statute, for extending the doctrine that the directors of a corporation are trustees for the creditors after insolvency, to cases in which the corporation is merely in an embarrassed position, but not actually insolvent. Until insolvency supervenes the directors have usually no fiduciary duties except as regards the stockholders. Thus the president of a railroad company sustains no fiduciary relation to holders of its bonds, which requires him as trustee or agent of such bondholders to see to the proper application of the funds received from the sale of the bonds, or to account to the bondholders for any surplus from the proceeds of the bonds they may hold after constructing the works for which they were issued. His relations and duties in this respect are to the company and its stockholders, not to creditors. Van Weel *v.* Winston (1885), 115 U. S. 228; Beach *v.* Miller (1889), 130 Ill. 162; s. c. 22 N. E. Rep. 464.

[2] Of course the terms of the mortgage may be such as to justify imputing to

There is, however, some lack of clearness in the cases with regard to the question what that precise characteristic of a railroad may be which justifies this marked departure from ordinary principles. Possibly it may be said that there has been a development of opinion on the subject. In Fosdick *v.* Schall, *supra*, the Supreme Court relied upon the largeness of the amounts involved, the complicated nature of the various rights to be adjusted, and, above all, on the fact that the business of railroad companies is done to a greater or less extent on credit, and that debts for labor, etc., are often allowed to accumulate in order to procure funds for the payment of interest. It is obvious, however, that none of these features are peculiar to railroads. The same remarks would be equally applicable to any great industrial enterprise. It seems altogether impossible to maintain with any show of plausibility that the rights of persons who help to keep up a railroad should, on such grounds alone, be regarded as essentially different from the rights of persons who keep up a mill, a foundry, or a shipbuilding establishment. The mere magnitude and complication of the interests involved, and the practice of carrying on the business on credit, seem to furnish an especially unsatisfactory basis for singling out the former class of creditors, when it is remembered that the equity, if it exists at all, must avail not merely in favor of the creditors of the very largest system of railroad lines, but also in favor of the creditors of a line a few miles long, the business of which is insignificant compared with that of hundreds of the great factories throughout the country.

The objections to resting the preference of debts for labor, etc., solely upon the grounds assigned in Fosdick *v.* Schall seem to be recognized in later decisions of the Supreme Court of the United States, and we think it may now be taken as the established doctrine that the differentiating feature in the cases considered in the present chapter is the interest which the public have in the

them an implied consent to holding their bonds on this condition; as where the mortgagors, as long as they remain in possession, are placed by the mortgage itself under the obligation of applying the income "to the payment of the current expenses of the road, . . . or of disposing of the same for the lawful uses" of the mortgagors. Under these circumstances the mortgagees may well be regarded as having taken their security, burdened with an express trust, that current expenses are to be paid out of current earnings. As, therefore, they have, while out of possession, no right to earnings superior to the mortgagor's, it is proper that the net income accruing after the appointment of a receiver should be first applied to the discharge of debts that were incurred to defray current expenses. Poland *v.* Lamoille Valley R. Co. (1879), 52 Vt. 144. Our observation in the text is intended to apply to cases where there are no unusual conditions in the mortgage from which a modification of rights may be inferred.

continued operation of the railroad "as a going concern." In other words, the preference of such debts can apparently be justified only on the hypothesis that, for some special reason of public policy, the business must be kept on foot at all costs; and this reason can only be found in the fact that the State has certain rights in regard to railroads which are paramount to those of the company and its creditors. Thus in Miltenberger *v.* Logansport Ry. Co.[1] Mr. Justice Blatchford made the following remarks in the course of his opinion: —

"Many circumstances may render it necessary and indispensable to the business of the road and the preservation of the property for the receiver to pay pre-existing debts of certain classes out of the earnings of the receivership, or even out of the *corpus* of the property. Yet the discretion to do so should be exercised with great care. The payment of such claims stands, *prima facie*, on a different basis from the payment of claims arising under the receivership, while it may be brought within the principle of the latter by special circumstances. It is easy to see that payment of unpaid debts for operating expenses, accrued within ninety days, due by a railroad suddenly deprived of the control of its property, due to operatives in its employ, whose

[1] 106 U. S. 286 (1882). This aspect of the subject has been strongly emphasized in one case decided not long before Fosdick *v.* Schall, in these words: "A railway is matter of public concern. It is one of the great instruments of modern commerce between States and nations. The public as well as private interests require its continual operation. To refuse to pay anything whatever for past services or supplies or materials has never, it is believed, been attempted by any court or even demanded by any mortgagee." Turner *v.* Indianapolis, B. & W. R. Co. (1878), 8 Biss. 315. The paramount rights of the public have never been stated more strongly than in Talcott *v.* Township of Pine Grove (1872), 1 Flip. 145, 23 Fed. Cas. No. 13,735, which, however, was not a case dealing with preferential debts. In the relation of the railroad to the public or sovereign, "the incidental interest and profits of individuals are accidents both in theory and practice. Every farthing of its tolls is first to be diverted to paying the public tax, and to the continuance of the road, its ample equipment and regular operation, as the interests of the community, not those of the shareholders, demand. No matter that a dividend is never paid, that the private investment is sunk and worthless, that the interest upon its bonds is never met, and that all its creditors go unpaid, every dollar of its earnings must nevertheless be applied to keep up its maximum efficiency, as required by the political power which created it." "The road once constructed is, *instanter*, and by mere force of the grant, and law, embodied in the governmental agencies of the State, and dedicated to public use. All and singular its cars, engines, rights of way, and property of every description, real, personal, and mixed, are but a trust fund for the political power, like the functions of a public office. The judicial personage, the corporation created by the sovereign power expressly for this sole purpose and no other, is in the most strict, technical, and unqualified sense but its trustee. This is the primary and sole, legal, political motive for its creation."

cessation from work simultaneously is to be deprecated, in the interests both of the property *and the public*, and the payment of limited amounts due to other and connecting lines of road for materials and repairs, and for unpaid ticket and freight balances, and the outcome of indispensable business relations, where a stoppage of the continuance of such business relations would be a probable result, in case of non-payment, — *the general consequence involving largely also the interests and accommodation of travel and traffic*, may well place such payments in the category of those made to preserve the mortgage property in a large sense, by maintaining the good-will and integrity of the enterprise, and entitle them to be made a first lien."

So also in Wood *v.* Guarantee Trust & Safe Deposit Co.,[1] where it was attempted to apply the doctrine of preferential debts in favor of the supply creditor of a water-works company, Mr. Justice Lamar took occasion to point out that this doctrine had never been countenanced in any case except that of a railroad company; but an express ruling on the point was deemed to be unnecessary, in view of other considerations which were conclusive against the enforceability of the plaintiff's claim.

A distinguished circuit judge announced the same principle still more distinctly in the following language: "Underlying the rule which the Supreme Court has laid down in respect to the payment of prior unsecured debts recently accrued, runs the thought that a railroad corporation owes a duty to the public which has given it its franchise and enabled it to construct its road, — the duty of operating that road for the benefit of the public." [2]

That the doctrine as to the preferential debts of railroad companies can be justified only by the *quasi* public character of such corporations has been directly ruled by the New York Court of Appeals, which has decided that the "back claims" of the employees of an insolvent hotel company have no such superior equity as against the claims of the secured creditors; that a receiver, appointed at the instance of the latter, should be authorized to pay them in preference to the mortgage bonds of the corporation.[3]

[1] 128 U. S. 416 (1888).

[2] Central Trust Co. *v.* Wabash, St. L. & Pac. Ry. Co. (1885), 23 Fed. Rep. 863, per Brewer, J.

To the same effect see Bound *v.* South Carolina R. Co. (1891), 47 Fed. Rep. 30, and the cases cited in the following section.

[3] Raht *v.* Attrill (1887), 106 N. Y. 423. Referring to the cases in the Supreme Court of the United States, Judge Andrews, on p. 436, said: "We have not lost sight of the recent very important cases decided in the Supreme Court of the United States, involving the question of the power which may be vested by the

§ 600. **What Corporations are Subject to the Rule.** — What corporations, if any, besides railroad companies are within the scope of the rule has not as yet been settled precisely by the courts. It has been held that the test is whether the corporation has exercised, or can legitimately exercise, the right of eminent domain for the purpose of facilitating the conduct of its business, and the rule is therefore not applicable to carriers by water.[1]

Applying this ultimate test, it is clear that such corporations as hotel, mining, manufacturing companies, and the like, would have to be excluded from the application of the rule[2] and denied in another.[3]

Possibly a definite conception may be arrived at by considering that the doctrine of preferential claims is applied, in the case of railroad companies, not solely on account of that public character which demands that they shall be kept up as a going concern, but also because, owing to the peculiar character of the business, there is a more than ordinary danger that their operation will be interrupted if certain back claims are not paid. The plant and equipment of a railroad, it is obvious, are essentially different from the plant and equipment of a gas company or a water com-

court in receivers of insolvent railroad corporations, and the rights of the court to provide for the payment of certain debts contracted before or after the appointment of a receiver out of income, and if that is inadequate, out of the *corpus* of the property. These cases and decisions are the outcome of the growth of railroad enterprises and business within a comparatively recent period. It has been held that under special circumstances the court may direct the payment of antereceivership debts for labor or supplies contracted within a limited period before the insolvency, the adjustment and payment of traffic balances in favor of connecting roads, and may direct the receiver to operate the road pending foreclosure, and to that end purchase necessary rolling-stock for the use of the road and make repairs and improvements thereon, the expense of which shall be a charge on the property in priority to legal liens. (Wallace *v.* Loomis (1877), 97 U. S. 146; Fosdick *v.* Schall (1879), 99 U. S. 235; Barton *v.* Barbour (1881), 104 U. S. 126; Miltenberger *v.* Logansport Railway Co. (1882), 106 U. S. 286; Union Trust Co. *v.* Soutter (1882), 107 U. S. 591; Burnham *v.* Bowen (1884), 111 U. S. 776; Union Trust Co. *v.* Illinois Midland R. Co. (1886), 117 U. S. 434.) It cannot be successfully denied that the decisions in these cases vest in the courts a very broad and comprehensive jurisdiction over insolvent railroad corporations and their property. It will be found on examining these cases that the jurisdiction asserted by the court therein is largely based upon the public character of railroad corporations, the public interest in their continued and successful operation, the peculiar character and terms of railroad mortgages, and upon other special grounds not applicable to ordinary private corporations."

[1] Bound *v.* South Carolina R. Co. (1892), 50 Fed. Rep. 312.

[2] Merchants' Bank of Atlanta *v.* Moore (1895), 106 Ala. 646; s. c. 17 So. Rep. 705; Laughlin *v.* United States Rolling Stock Co. (1894), 64 Fed. Rep. 25; Hooper *v.* Central Trust Co. (1895), 81 Md. 559; s. c. 32 Atl. Rep. 505, and the cases cited in the preceding section.

[3] Hunt *v.* Memphis Gaslight Co. (1895), 95 Tenn. 136; s. c. 31 S. W. 1006.

pany. The former is only valuable in so far as it is kept in readiness to meet the demands of a business which is one of constant change and flux, dependent to a large extent upon a variable body of customers. The latter is designed to serve the requirements of a business which would suffer comparatively little from a temporary stoppage, and this is all that is to be apprehended in the case of either class of business. The central consideration, therefore, which has influenced the courts to exercise this extraordinary jurisdiction in the case of railroads is wanting, or, at all events, is very much less prominent in the case of other corporations which are unquestionably of a *quasi* public nature. This difference constitutes a perfectly adequate reason for denying the allowance of any preferences except to the creditors of railroad companies.

It has also been decided that the doctrine of preferential debts is not applicable to a manufacturing company;[1] even if there has been a diversion of earnings in favor of the mortgage creditors.[2]

It is not irrelevant to notice in the present connection that the analogous powers conferred upon receivers in regard to borrowing money on the security of the *corpus* of the estate for the purpose of keeping the road in operation have been still more distinctly placed upon the ground of the public interest in the duties which a railroad company undertakes when it is organized. (See Chap. XXIX.)

In a very late federal case it was held that the doctrine of the case of Fosdick *v.* Schall, 99 U. S. 235, will not be applied in foreclosure suits against any other corporations than railroad companies.[3]

But there are other corporations, the position of which with respect to the doctrine is, in the present state of the authorities, somewhat difficult to fix. That no preference will be granted to back claims against a waterworks company is settled, — a doctrine which seems to involve the conclusion that the power to exercise the right of eminent domain is not a decisive test.[4]

[1] Seventh National Bank *v.* Shenandoah Iron Co. (1887), 35 Fed. Rep. 436.

[2] Snively *v.* Loomis Coal Co. (Phœnix Powder Mfg. Co., Intervener), (1895), 69 Fed. Rep. 204.

In the last cited case the court distinctly took the ground that there was no public interest requiring such a corporation to be continued as a going concern.

[3] Ford *v.* Central Trust Co. (1895), 70 Fed. Rep. 144; s. c. 17 C. C. A. 31. See Haima *et al.* *v.* State Trust Co. *et al.* (1895), 70 Fed. Rep. 2; s. c. 16 C. C. A. 586.

[4] Wood *v.* Guarantee Trust & Safe Deposit Co. (1888), 128 U. S. 416. The Supreme Court of the United States in this case is evidently inclined to hold that the doctrine of preferential debts is applicable *only* to railroads, though it was not so decided in explicit terms, and the case went off on another point. In Ellis *v.* Vernon Ice, etc. Co. (1893), 86 Tex. 109, however, it was held that a waterworks

That a gas company is on the same footing as a railroad has been asserted in one case.[1]

§ 601. **Anomalies of the Doctrine as now administered.** — But even if it is conceded that the protection of the public interests furnishes a sufficient ground for the exercise of this novel jurisdiction; that "the ends of justice have been promoted" by the action of the courts in paying preferential debts;[2] that "there is justice in paying out of the income the working-men and material-men, who have kept the road in use;" and that "their preference places the bondholders in no worse condition than they would have been if payment had been made when the debts were contracted,"[3] — it seems fairly open to question whether the whole matter would not have been settled upon a more satisfactory basis if its adjustment had been left to the legislature. Two inconsistencies inherent in the judge-made law which is now administered might in that way have been obviated. In the first place, there seems to be no adequate reason why the courts should draw the line defining preferred debts at those which are incurred for operating expenses, and refuse to interfere in those equally meritorious cases where the company has failed to pay the expenses of construction.[4] It is evident that even where the company, as is commonly the case, is not the direct paymaster of the persons who furnish labor and supplies for building the road, the inability of the company to discharge a debt due to the contractors who actually do the construction work, must necessarily, as such operations are usually conducted, involve the non-payment of the employees of these contractors.

The bondholders get the advantage of this labor and these supplies just as clearly as they get the advantage of the labor and supplies furnished while the road is in operation. Why should the fact that the security is benefited be, in one case, a reason for favoring those who have contributed to the result, and not in the other? The actual creation of the security ought to be regarded as a work entitling those who have participated therein to as much favor as those who have contributed to preserve the security after its creation.[5]

company was so far public as to justify keeping it up by the issue of receivers' certificates, a ruling which cannot be reconciled with the case just cited.

[1] Reyburn *v.* Consumers' Gas Co. (1887), 29 Fed. Rep. 561.

[2] Farmers' Loan & Trust Co. *v.* Kansas City, W. & N. W. R. Co. (1892), 53 Fed. Rep. 182, per Caldwell, J.

[3] Clark *v.* Williamsport R. Co., an unreported case decided by Mr. Justice Strong while on the Supreme Bench of Pennsylvania.

[4] See below, § 634.

[5] This view has been taken in a recent case by Judge Caldwell, though the allowance of debts for construction was as a matter of fact assented to by the trustees.

In the second place, legislation might have been so framed as not to make the payment of these debts dependent upon the circumstance of the appointment of a receiver. If the claims preferred are really meritorious, there surely cannot be instanced a more deplorable result of the separation of law and equity than that they should go unpaid simply because the mortgagee elects to assert his rights. Yet such seems to be the unquestioned rule according to the highest authority.[1]

§ 602. **Theory that Company becomes Agent sub Modo of Bondholders, if allowed to remain in Possession.** — The theory that the company, if allowed to remain in possession after default, becomes the agent of the bondholders for the purpose of contracting debts

Farmers' Loan & Trust Co. *v.* Kansas City, W. & N. W. Ry. Co. (1892), 53 Fed. Rep. 182. The learned judge thought it a matter for congratulation that this anomaly is gradually disappearing through the enactment of appropriate legislation. See the note appended to the report of this case for a list of the statutes recognizing the meritorious character of construction debts.

In Vermont the right of a railroad company to mortgage all its personal property without the necessity for a change of possession is only subject to the right of a creditor to attach that property to secure payment of a claim "for services rendered or materials furnished for the purpose of keeping the road in repair or in running the same." Poland *v.* Lamoille Valley Ry. Co. (1879), 52 Vt. 144.

[1] Fosdick *v.* Schall (1879), 99 U. S. 235; s. c. 8 Fed. Rep. 449. In Central Trust Co. *v.* East Tennessee, Va. & Ga. R. Co. (1886), 30 Fed. Rep. 895, it is stated *obiter* that the doctrine of preferential debts is applicable to cases where the trustee takes possession, and the above decision of the Supreme Court of the United States, and Burnham *v.* Bowen (1884), 111 U. S. 776; s. c. 17 Am. & Eng. R. R. Cas. 308, are cited as authorities. This is certainly an error, as no such doctrine is laid down in these cases. In fact Fosdick *v.* Schall is a distinct authority against it. In Burnham *v.* Bowen Chief Justice Waite said: "If the trustees had taken possession under the mortgage, they would have been subject to similar expenses to do what the company, with their consent and approbation, was doing for them." But this remark has certainly no such meaning as that ascribed to it. The point does not seem to have been directly raised in any case, but in Duncan *v.* Mobile & Ohio R. Co. (1876), 2 Woods, 542, Judge Woods refused to direct trustees in possession to apply the income to the payment of certain floating indebtedness, even though a part of it had been contracted by the company to pay off bonded interest and to make permanent improvements, and though it was represented that a scheme of reorganization would be greatly facilitated by such an application of the fund. The latter of these reasons would of course have had no weight even if the court had been considering the petition of a receiver; but under the doctrine of Fosdick *v.* Schall it is clear that, if the property had been in the hands of a receiver, the bondholders would have been bound to submit to the replacement of any part of the floating debt which had been applied to interest or betterments. The case is therefore a distinct authority for the rule stated in the text, though, as it was decided before the principle of the restoration of diverted earnings was clearly formulated, its pertinence is of a somewhat negative character.

In Canada the trustees who go into possession cannot be held liable for materials furnished or work done previous to their possession: Wallbridge *v.* Farwell (1890), 18 Can. S. C. 1.

for operating expenses, has been put forward in some cases as a reason why such debts should be paid in preference to the bonds. It seems clear, however, that there must be something more than a mere failure to take possession in order to raise an estoppel on this ground.[1]

To produce that result, the period during which the company were allowed to operate the road must have been so considerable as to justify the inference that the bondholders impliedly consented that the earnings of the road should be used to discharge such expenses as are incurred in a greater or less degree for their benefit.[2]

[1] Blair *v.* St. Louis, H. & K. R. Co. (1884), 22 Fed. Rep. 471; Hiles *v.* Case (1880), 9 Biss. 549; s. c. 14 Fed. Rep. 141; reported also *sub nom. In re* Dexterville Mfg. & Boom Co. (1880), 4 Fed. Rep. 873; Skiddy *v.* Atlantic, Miss. & Ohio R. Co. (1878), 3 Hughes, 320, 340.

In Blair *v.* St. Louis R. Co., *supra*, the master had reported in favor of all claims accruing since the first default in the payment of interest, a period of over two years. Judge Brewer thus commented on this action: "This seems to proceed on the assumption that the mortgagees, by failing to take action, have made the mortgagor company their agent to incur debts; have impliedly consented that all such debts should take preference of their secured claims. I do not think that this principle is sound. There is no implied agency to that extent, and I do not think that the rulings of the Supreme Court are based upon any such doctrine. The idea which underlies them I take to be this: that the management of a large business, like that of a railroad company, cannot be conducted on a cash basis. Temporary credit, in the nature of things, is indispensable. Its employees cannot be paid every month. It cannot settle with other roads its traffic balances at the close of every day. Time to adjust and settle these various matters is indispensable. Because in the nature of things this is so, such temporary credits must be taken as assented to by the mortgagees, because both the mortgagees and the public are interested in keeping up the road, and having it preserved as a going concern, and whatever is necessary to accomplish this result must be taken as assented to by the mortgagees. In this view, such temporary credits accruing prior to the appointment of the receiver must be recognized by the mortgagees and such claims preferred."

[2] Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 260, 267, where Judge Caldwell said, among other things: "It is no answer to say the company used its earnings for other purposes. The bondholders knew such liabilities must be incurred in running the road. They had it in their power to take possession of the road and secure its earnings to pay such liabilities. The class of persons protected by this order could not do anything to protect themselves, or compel a different application of the earnings. The misapplication of the earnings, if there was any, is not, therefore, to prejudice the class of creditors named. The right to require the payment of such debts does not depend on whether current earnings have been used to pay the mortgage debt." So also in Duncan *v.* Trustees (1876), 9 Am. Ry. Rep. 386; 3 Centr. L. J. 579, the court expressed a similar opinion in the following words: "The Chesapeake & Ohio R. Co. had been so long in default that the right of the bondholders to claim possession was fully consummate, and this was a matter of common notoriety. It could not be expected that the employees all along the track of this road would pause amid their increasing round of daily duty to inquire whether the bondholders had or had not asserted their rights and assumed control. It was enough for them to know that the service they were rendering was such service as any proprietor

The whole theory of an implied assent, even with this qualification, has been vigorously combated by Judge Jenkins in a recent case, as follows: "If failure to take possession works an implied assent that the earnings should be applied in compensation of casualties in priority to the mortgage, why not as to all floating indebtedness, to all improvements upon the road, and irrespective of time? Why not say that, through failure to take possession, the bondholders assent that earnings should be devoted to the payment of all debts incurred after default in the payment of interest, and in priority thereto? Why limit such priority to the period of six months prior to the receivership? If priority is to be predicated upon implied assent instead of upon benefit to the *res*, it should be allowed to all claims arising during failure to take possession from which assent is implied. The priority should be coextensive in point of time with the implied assent. That logically results from the principle bottomed upon implied assent. Such doctrine is, to my thinking, a broad departure from the equitable doctrine declared by the Supreme Court, and would be ruinous in its consequences. If conceded, the entire floating debt of a railway company, occurring after default in payment of

would necessarily require, and they had a right to believe that all the officers left in notorious occupancy of the property, and charged before the public with the responsibility of its care and custody, were abundantly authorized to act for all whom it might concern in contracting for their services. . . . These employees had every right to believe that, so long as the bondholders stood aloof without asserting their rights to possession, they were willing to accept and regard *pro tanto* as their agents for the preservation and protection of the property the persons who, placed in charge thereof by their defaulting debtor, could not, in good faith to the creditor or the debtor, abandon their posts or be derelict, while they had them, to the trusts which they imposed." So also in Williamson's Admin. *v.* Washington City, Va. Midl. & Grt. Southern R. Co. (1880), 33 Gratt. 624; s. c. 1 Am. & Eng. R. R. Cas. 498, the court considered that the fact of the mortgagees having left the company in possession for several years, and allowed it to obtain credit upon the faith of its control of the earnings, furnished a good and sufficient reason for requiring the debts contracted for operating expenses to be paid before the court would exercise its discretion in appointing a receiver. In Union Trust Co. *v.* Souther (1882), 107 U. S. 591; s. c. 11 Am. & Eng. R. R. Cas. 707, the failure of the trustees to take possession for three months after the period of continued default which gave them that right was mentioned among the circumstances which may make an order to pay the back claims of a material-man not an unreasonable exercise of the discretion of a court which is asked to appoint a receiver; but the court does not take the position that the company thereby becomes the agent of the bondholders. The diversion of the earnings had, in fact, taken place with the consent of the bondholders.

In Douglass *v.* Cline (1877), 12 Bush (Ky.), 608; 18 Am. Ry. Rep. 273, the court lays some stress upon the fact that the debts for which a preference was claimed were incurred during a period when the bondholders "either could or could not interfere to protect their security." But the decision was rendered on the broader ground of the superior equity of the claims.

interest, and during failure to take possession, would necessarily and logically be given priority. Vested rights of property would be subjected to great detriment under such holding. The bonds of American railways are scattered throughout Europe, and are held in many hands. It requires much time to institute concerted action by the holders after default in payment of interest. Meantime unprincipled directors, anxious to retain possession of the road, could contract indebtedness, — given priority by such ruling, — working ruin to the mortgage interest. The bondholder would be 'improved out of his estate,' and his vested rights placed at the mercy of hostile directors. I am unwilling to assent to such doctrine. I do not understand it to be the law." [1]

Article II. — Priority of Back Claims.

§ 603. **Power of Court on Appointment of Receiver to impose Conditions as to Payment of Back Claims.** — The power of the court to require the payment of certain back claims as a condition of granting a receivership is made to rest upon the fact that it is within the discretion of the court to give or refuse this kind of relief. The assumption being that, for the reasons already enlarged upon, the bondholders are bound in equity to see these claims paid before they themselves have any right to the income, it follows that the court may require them to do equity in order that they may receive equity.[2]

[1] Farmers' Loan & Trust Co. *v.* Green Bay, W. & S. W. R. Co. (1891), 45 Fed. Rep. 664; s. c. 46 Am. & Eng. R. R. Cas. 296. So also in Farmers' Loan & Trust Co. *v.* Chicago & A. Ry. Co. (1889), 42 Fed. Rep. 6; s. c. 8 Ry. & Corp. L. J. 184, Judge Gresham said that "it does not follow that, because the bondholders failed to exercise at an earlier day their right to foreclose for the principal indebtedness, and in that connection ask for a receiver, they thereby constitute the corporation their agent for all purposes in the operation of the road."

[2] Fosdick *v.* Schall (1879), 99 U. S. 235; s. c. 7 Fed. Rep. 449; Douglass *v.* Cline (1877), 12 Bush (Ky.), 808; s. c. 18 Am. Ry. Rep. 273; Poland *v.* Lamoille Valley R. Co., 52 Vt. 144; Williamson *v.* Washington City, Va. Midl. & Great Southern R. Co. (1880), 33 Gratt. 624; s. c. 1 Am. & Eng. R. R. Cas. 498; Ellis *v.* Boston, Hartford, & Erie R. Co. (1871), 107 Mass. 1. In Douglass *v.* Cline, *supra*, Judge Cofer delivered an elaborate dissenting opinion in which he combated vigorously, and with much justice, this novel application of a familiar maxim of equity. The ordinary meaning of the maxim, it was pointed out, was not that the plaintiff should do equity to some third party, but that he should do equity to the defendant in regard to the subject-matter of the litigation. In cases of any other kind, it has never been contended that a chancellor should refuse to grant a relief against B., because the complainant has an unfair advantage against C. The position of the bondholders is, however, really much stronger than this, for according to the principles of equity, as usually administered, it cannot be maintained that in seeking to secure all the earnings from the time the default of the company gives them the right to foreclose, they are taking an unfair advantage of any one.

This power of the court does not depend on whether current earnings have or have not been used to pay interest, or to increase the value of the property.[1]

§ 604. **Limits of Discretionary Power of the Court to impose Conditions as to Payment of Back Claims.** — It is not to be expected that a standard so vague as the discretion of the court will be applied with entire uniformity of results to the determination of the question, what back claims may properly be provided for in an order of appointment of a receiver. Some courts have gone so far as to extort the assent of the bondholders to schemes of liquidating antecedent debts, which amount to giving all the general creditors a prior claim upon the income of the receivership. This seems an unwarrantable exercise of judicial discretion, and the Supreme Court of the United States has, in a recent case, animadverted in severe terms upon such abuse of power: "The appointment of a receiver vests in the court no absolute control over the property, and no general authority to displace vested contract liens. Because in a few specified and limited cases this court has declared that unsecured claims were entitled to priority over mortgage debts, an idea seems to have obtained that a court appointing a receiver acquires power to give such preference to any general and unsecured claims. It has been assumed that a court appointing a receiver could rightfully burden the mortgaged property for the payment of any unsecured indebtedness. Indeed, we are advised that some courts have made the appointment of a receiver conditional upon the payment of all unsecured indebtedness in preference to the mortgage liens sought to be enforced. Can anything be conceived which more thoroughly destroys the sacredness of contract obligations? One holding a mortgage debt upon a railroad has the same right to demand and expect of the court respect for his vested and contracted priority as the holder of a mortgage on a farm or lot. So, when a court appoints a receiver of railroad property, it has no right to make that receivership conditional on the payment of other than those few unsecured claims which, by the rulings of this court, have been declared to have an equitable priority. No one is bound to sell to a railroad company, or to work for it; and whoever has dealings with a company whose property is mortgaged must be assumed to have dealt with it on the faith of its personal responsibility, and not in expectation of subsequently displacing the priority of the mortgage liens. It is the exception and not the rule that such priority of liens can be

[1] Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 260.

displaced. We emphasize this fact of the sacredness of contract liens, for the reason that there seems to be growing an idea that the Chancellor, in the exercise of his equitable powers, has unlimited discretion in this matter of the displacement of vested liens."[1]

§ 605. **Claimants in Order of Appointment not invested with Absolute Right as against Bondholders.** — An order appointing a receiver does not vest in the claimants coming within its terms an absolute right as against the security holders. Its terms are a protection to the receiver himself; and what he does and pays within those terms is thereafter beyond the challenge of any party interested in the property. But when he has not paid a claim which it is alleged comes within the terms of the order, and the question is presented to the court as to the liability of the property for the claim, the court is not foreclosed by the order, but may determine the extent of liability of the property to such claim, and what its rights of priority may be.[2]

§ 606. **Upon whom Conditions of Order are binding.** — Conditions imposed as to the discharge of back claims are binding not only on the party who asks for the appointment of the receiver, and accepts it on the terms laid down, but also on any one who may afterwards come into the litigation.[3]

As to any particular claim, the order is conclusive where all

[1] Kneeland *v.* American Loan Co. (1890), 136 U. S. 89; 43 Am. & Eng. R. R. Cas. 519. So far as regards the subject-matter, the proper limits of a chancellor's discretion in requiring the payment of back claims are probably indicated with sufficient accuracy in the following brief but comprehensive order, issued in one of the cases: "It is further ordered, adjudged, and decreed that the said receiver, out of the income that shall come into his hands from the operation of the said railroad or otherwise, do proceed to pay all just claims and accounts for labor, material, supplies, salaries of officers and wages of employees, that may have been earned or furnished within six months prior to" a specific date. See the statement of facts in Louisville, Evansville, & St. Louis R. Co. *v.* Wilson (1891), 138 U. S. 501. A more lengthy example of an order of appointment providing for the payment of back claims will be found in the report of the case of Union Trust Co. *v.* Illinois Midland Ry. Co. (1886), 117 U. S. 434; s. c. 25 Am. & Eng. R. R. Cas. 560.

[2] Louisville, Evansville, & St. Louis R. Co. *v.* Wilson (1891), 138 U. S. 501.

[3] Calhoun *v.* St. Louis & S. W. Ry. Co. (1880), 14 Fed. Rep. 9, 10. The court said: "Parties in court at the time are certainly bound by an order made when the court took jurisdiction of the case, and all coming into the litigation afterwards must be considered as coming subject to the policy which had been prescribed by the court in relation to the payment of the labor and supply claims, and certainly subject to the order as modified by the court at the instance of the first mortgagees. Then it follows that, under the rule in Fosdick *v.* Schall, the condition imposed upon the property should adhere to it during the progress of the litigation, and all claims coming within the terms of the order of the court should be paid in the manner there pointed out."

the parties accept it, whether or not the court had the power to require its payment in the first instance.[1]

§ 607. **Back Claims to be preferred need not be particularized in the Order.** — It is not always possible to determine before the receiver is appointed what claims are in equity paramount to the mortgage, and they need not be precisely specified in the order of appointment. The receiver may be directed to pay such claims as the master shall report to be equitably entitled to priority.[2]

§ 608. **Limits of the Power to prefer Unsecured Debts when no Provision is made for the Payment in Order appointing a Receiver.** — The decision in Fosdick *v.* Schall left one important point in an unsettled condition, as the court did not express any opinion as to whether back claims could be enforced in those cases in which no order had been made for their payment, when the receiver was appointed, and there was no proof of diversion. This question was partially resolved in Miltenberger *v.* Logansport Ry. Co.,[3] in which it was held that arrears of wages and sums due to connecting lines for which no provision had been made in the order of appointment, might be paid, where the case was brought by special circumstances within the principle which regulates the payment of claims arising during a receivership. Circumstances justifying such a payment were held to exist if it was apparently necessary for the purpose of keeping the road in operation, or, in other words, if the protection and preservation of the property as a "going concern" required it.

In Burnham *v.* Bowen[4] this circumscribed doctrine was ex-

[1] Union Trust Co. *v.* Atchison, T. & S. F. R. Co. (Madden, Intervener), (1895), 42 Pac. 89.

[2] Blair *v.* St. Louis H. & K. R. Co. (1884), 22 Fed. Rep. 471, 474.

[3] 186 U. S. 286 (1882). A similar conclusion had previously been arrived at in Skiddy *v.* Atlantic, Miss. & Ohio R. Co. (1878), 3 Hughes, 320, where, upon the receiver's representing that the payment of certain back claims for the wages of persons still in the employment of the company was necessary for the safe and successful operation of the road, and that he could not be responsible for the consequences of a refusal of it by the court, an order was made for the payment of arrears for eight months, although no conditions were imposed at the appointment of the receiver, but as to the back claims of employees no longer in the service of the company the priority of the mortgage was strictly upheld, the great hardship of many of the cases being at the same time conceded.

[4] 111 U. S. 776; s. c. 17 Am. & Eng. R. R. Cas. (1884). In this case the Circuit Court had used the income of the receivership to pay the fixed prior charges on the mortgaged property, and thus increase the security of the bondholders. A decree of strict foreclosure was then rendered, the rights of all interveners, of whom Bowen was one, being saved, and the case continued for the final determination of all such questions as the one under discussion. The court held that, "as the diversion of the fund by the receiver created in equity a charge on the property as security for the restoration, the mort-

panded, and the general rule laid down that, even if no special provision has been made for the payment of operating expenses in the order appointing the receiver, a court of chancery when it takes possession of mortgaged railroad, and thus deprives the company of the power of receiving any further earnings, ought to do what the company would have been bound to do, if it had remained in possession; that is to say, "pay out of what it receives from the earnings all the debts which, in equity and good conscience, considering the character of the business, are chargeable upon such earnings." The result of this decision, therefore, is that debts of this class are an absolute charge in equity on the continuing income, as well that which comes in the hands of the court after the receiver is appointed as that which is collected by the company itself prior to such appointment, and that their payment may be enforced at any stage of the litigation, provided the court has control of the subject-matter.

In one recent case it has been ruled that preference cannot be accorded to a claim as to the *corpus* of the property, where no order has been made for its payment at the time of the receiver's appointment.[1]

In another it has been held that, under such circumstances, a claim cannot be made a charge either on the *corpus* or earnings.[2]

gagees, having elected to take the property under a decree of strict foreclosure, took it subject to the charge in favor of the current debt creditor whose money they had got." The point was also raised in another case decided in a Circuit Court about the same time as Burnham *v.* Bowen, and Judge Brewer expressly rejected the contention of counsel, that no unsecured claims can be preferred to the mortgage, unless there has been either a diversion of earnings, or the court has required their payment as a condition of appointing a receiver. Blair *v.* St. Louis, H. & K. R. Co. (1884), 22 Fed. Rep. 471. There it was held, on the authority of Miltenberger *v.* Logansport Ry. Co., *supra*, that certain labor and supply claims might be preferred. But the grounds on which that case was decided were, as we have seen, quite special, and it can scarcely be said to be an authority for allowing back claims, not provided for in the order of appointment, where there is no averment that their discharge is necessary for the preservation of the estate. The more extended doctrine of this case is, however, clearly within the principle of Burnham *v.* Bowen, *supra*. To the same effect see Central Trust Co. *v.* St. Louis, A. & T. R. Co. (1890), 41 Fed. Rep. 551; Farmers' Loan & Trust Co. *v.* Kansas City, W. & N. W. R. Co. (1892), 53 Fed. Rep. 182.

[1] Cutting *v.* Tavares, O. & A. R. Co. (Florida Cent. & P. R. Co. *et al.*, Interveners), (1894), 61 Fed. Rep. 150; s. c. 9 C. C. A. 40; 61 Fed. Rep. 15.

[2] Central Trust Co. *v.* Chattanooga & Southern R. Co. (1895), 69 Fed. Rep. 295, following the ruling of the Court of Appeals in the case last cited.

Holders of debentures charging all the property of the company as a floating security held preferred to subsequent creditors in a winding up. *In re* Opera (Lim.), (1891), 3 Ch. Div. 260; *In re* Standard Mfg. Co. (1891), 1 Ch. 627, 640, 641; *Re* Pyle Works, 44 Ch. Div. 534; *Re* General South American Co., 2 Ch. Div. 337; *Re* Bell (1886), 34 W. R. 363. They also have priority over general creditors. *Re*

The only precedent cited by the court in the former case was Fosdick *v.* Schall, which does not sustain any such doctrine as that attributed to it, the fact being, as already remarked, that the Supreme Court of the United States did not express any opinion whatever as to the rights of the parties, where no order embracing a claim has been made, except in the special case where a diversion of earnings is shown. These cases, so far as they are intended to lay down a general doctrine, are, it is evident, directly opposed to Miltenberger *v.* Logansport Ry. Co. and Burnham *v.* Bowen, *supra*, which, without in any way contradicting Fosdick *v.* Schall, have greatly expanded the scope of that decision. The Supreme Court is clearly committed to the doctrine that, within certain fixed limits, back claims not provided for in the order of appointment may be made a charge either on the income or (in extreme cases) on the *corpus*. In fact it is easy to see that any other position would be wholly illogical, and supported by no more valid ground than a sort of technical estoppel. Obviously, if a court has the right to refuse to appoint a receiver unless certain back claims are paid, it must also have a right to refuse to continue the receivership for the same reason. The narrow theory that, whatever is settled in the order of appointment is *res judicata* would be singularly out of keeping with the central principles underlying this extraordinary jurisdiction. If the court is to discharge effectually its function of seeing that the public interests do not suffer through the stoppage of the road, it must retain the capacity for postponing the claims of the bondholders at any stage of the proceedings, where the exigency requires it. To what extent those claims shall be postponed, whether as regards the income only or the *corpus*, is a question which, as was said in Miltenberger *v.* Logansport Ry., *supra*, must be decided according to the circumstances of the case. If it is simply a matter of equity and good conscience, the debt will be charged on the income only. If non-payment of the debt endanger the public interests, the court will not hesitate to make the *corpus* of the estate responsible for the satisfaction of the creditors' demand.

§ 609. **Assignee of Preferred Debt entitled to Preference.** — The assignee of a claim covered by an order appointing a receiver is as much entitled to its benefit as the original holder.[1]

Anglo-American Leather Cloth Co. (1879), 42 L. T. R. 507.

As to priority of a mortgagee under a renewal of his mortgage to unsecured creditors, see *Re* Underbanks Mills Cotton Co. (1868), 31 Ch. Div. 226.

[1] Union Trust Co. *v.* Walker (1884), 107 U. S. 596. "These creditors," said the court, "are paid not because they have in law a lien on the mortgaged property or the income, but because in equity the earnings of the company constitute a

§ 610. **Debts will not be preferred merely because Bondholder has promised Priority.** — The promise of a bondholder to see that a claim for personal services in making negotiations for a railroad, which is not shown to be of a character that gives it a preference over the mortgage, shall be paid before the bonds, is without consideration, and not enforceable.[1]

§ 611. **Judgment of another Court, when not conclusive as to whether a Claim is to be preferred.** — Since the priority of other claims can only be conceded at the expense of the bondholders, a judgment for a debt rendered in an action to which neither they themselves nor the receiver in their behalf are made parties is not admissible in another court, to establish that the debt is an equitable charge on the mortgaged property superior in dignity to the mortgage.[2]

§ 612. **Back Claims not ordinarily Lien on Corpus.** — That back claims will not ordinarily be made a charge upon the *corpus* of the estate follows as a necessary deduction from the principle that " the mere fact of the appointment of a receiver to preserve the property *pendente lite* does not change the character of a debt." Such an appointment does not confer the rank of a secured claim upon an unsecured claim for supplies,[3] or upon an unsecured claim for rent,[4] or upon an unsecured claim for arrears of salary.[5]

fund for the payment of the expenses which their claims represent, before any income arises which ought to be applied to the discharge of the mortgage debt. Under such circumstances it is a matter of no importance that the original creditor has parted with the claim. The right is one that attaches to the debt, and not to the person of the original creditor. Consequently the right passes with an assignment of the debt." S. P. Northern Pacific R. Co. *v.* Lamont (1894), 69 Fed. Rep. 23.

[1] Farmers' Loan & Trust Co. *v.* Pine Bluff, M. & N. O. Ry. Co. (Ark., 1893), 21 S. W. Rep. 652.

[2] Wabash, St. Louis, & Pac. Ry. Co. *v.* Central T. Co. (1887), 33 Fed. Rep. 238. There a creditor intervened in a federal court with a claim alleged to be prior to the mortgage lien, but, before any action was taken, he was allowed to dismiss his petition without prejudice. Thereafter he obtained in the State court a consent judgment against the company only on the same claim. It was held that this proceeding was, as regards the receiver, then representing the bondholders, *res inter alios acta*, and that the most that the claimant was entitled to, on the strength of the judgment, was a general unsecured allowance against the company.

[3] United States Trust Co. *v.* New York, W. S. & B. R. Co. (1885), 25 Fed. Rep. 800; Blair *v.* St. Louis, H. & K. R. Co. (1884), 22 Fed. Rep. 471. In the first of these cases the income of the receivership had not been sufficient to pay the expenses of operation, and the court said that, under these circumstances, the application of the creditor to enforce the payment of a claim not provided for in the order appointing the receiver was substantially a request to charge the *corpus* of the estate.

[4] Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1888), 34 Fed. Rep. 259, the court saying that receivers, although they are liable for rent, if they elect to adopt a lease (see Chap. XXXI.) due thereunder, are not bound to such an extent that the lien of the mortgage upon the *corpus* of the property is to be postponed to the claim for that rent.

[5] National Bank of Augusta *v.* Carolina, K. & W. R. Co. (1895), 63 Fed.

To justify making a past-due claim a charge on the *corpus*, the existence of some special equity must be affirmatively shown.[1]

§ 613. **Back Claims Lien on Corpus where Diversion of Earnings is established.** — That the earnings have been diverted by the company to the payment of interest or to permanent improvements of the estate is a well-recognized ground for declaring preferential debts to be a lien on the *corpus*, if the current income of the receivership is insufficient to discharge them.[2]

This rule rests, as we have seen in a former section, upon the principle that the earnings constitute a current debt fund, which cannot be legitimately applied to any claims until the operating expenses are fully paid.[3]

In other words, the income must be first devoted to the expenses of producing the income.[4]

If there has been a diversion of the earnings to the payment of interest, the right of the preferential creditors to demand restitution is not defeated by the fact that another portion of the earnings has been misapplied to the payment of a floating debt of previous years, which was entitled to no priority.[5]

The bondholders are not absolved from the obligation of restoring diverted earnings, for the reason that the mortgage gives, in terms, a lien on the profits and income; for, as we have seen in a preceding chapter, until possession of the mortgaged premises is actually taken, or something equivalent done, the whole earnings belong to the company, and are subject to its control.[6] (As to the restoration of earnings diverted during the receivership, see Chapter XXXI.)

§ 614. **Payments of Interest, when not Diversion of Earnings.** — Payments of interest are not a diversion of earnings as regards a creditor to whom there is nothing due at the time those pay-

Rep. 25. In this case the earnings of the road were insufficient to pay even the receiver's compensation, so that the reasons against granting the petition were stronger than usual.

[1] National Bank of Augusta *v.* Carolina, K. & W. R. Co. (1895), 63 Fed. Rep. 25.

[2] Fosdick *v.* Schall (1879), 99 U. S. 235; Union Trust Co. *v.* Souther (1882), 107 U. S. 59; s. c. 11 Am. & Eng. R. R. Cas. 707; Farmers' Loan & Trust Co. *v.* Vicksburg & Meridian R. Co. (1888), 33 Fed. Rep. 778; Calhoun *v.* St. Louis & S. W. Ry. Co. (1881), 14 Fed. Rep. 9, 10; Burnham *v.* Bowen (1884), 111 U. S. 776; St. Louis, A. & T. H. R. Co. *v.* Cleveland, C. C. & I. R. Co. (1888), 125 U. S. 658; s. c. 33 Am. & Eng. R. R. Cas. 16.

[3] Fosdick *v.* Schall, *supra*, § 597.

[4] Wood *v.* Guarantee Trust & Safe Deposit Co. (1888), 128 U. S. 416; s. c. 9 Sup. Ct. Rep. 131.

[5] Williamson *v.* Washington City, Va. Mdl. & Grt. Southern R. Co. (1880), 33 Gratt. (Va.) 624; s. c. 1 Am. & Eng. R. R. Cas. 498.

[6] See the remarks of Justice Harlan in Thomas *v.* Peoria & R. I. R. Co. (1888), 36 Fed. Rep. 808; s. c. 36 Am. & Eng. R. R. Cas. 381.

ments are made. A lessor of an insolvent road, for example, cannot claim the restoration of earnings thus used, where the evidence shows that the rent was not in arrear when the bondholders were paid their interest. A solvent road is not bound to accumulate income with a view to possible future inability to pay rent or other operating expenses.[1]

Nor can the payment of interest be treated as a diversion where the mortgagees have themselves advanced, for the purpose of keeping up the road, more than the amount thus paid.[2]

Nor is there any diversion where the money applied to the payment of interest constitutes a portion of the funds of the corporation which has not yet become a "going concern," and which, therefore, has no income to use for any purpose.[3]

§ 615. **Back Claims may be made Lien on Corpus if Preservation of Property requires.** — The impossibility or extreme difficulty of preserving the property in any other way will, in some special cases, constitute a sufficient reason for making back claims a lien on the *corpus*, even if no diversion of earnings is shown.[4] But this should not be done without giving the adverse parties an opportunity to be heard.[5]

It is only in the case of railroads that payment of back claims can be ordered on this ground. A debt created by the receiver of the property of an insolvent hotel company to pay off arrears of wages, on the ground that, unless they are so paid, there is a serious risk that the property will be destroyed or seriously damaged by riotous employees, is not an expense incurred for the

[1] St. Louis, Alton, & Terre Haute R. Co. *v.* Cleveland, C. C. & I. R. Co. (1888), 125 U. S. 658; s. c. 8 Sup. Ct. Rep. 1011.

[2] Ibid.

[3] Wood *v.* Guarantee Trust & Safe Deposit Co. (1888), 128 U. S. 416; s. c. 9 Sup. Ct. Rep. 131.

[4] Miltenberger *v.* Logansport Ry. Co. (1883), 106 U. S. 286; s. c. 12 Am. & Eng. R. R. Cas. 464. (For an extract from this case showing the considerations which influenced the court in upholding these allowances, see *ante.*) There arrears of wages due to operatives within ninety days, and amounts due to connecting lines for materials and repairs, and for ticket and freight balances, were held to have been properly discharged out of the proceeds of the sale of the *corpus*.

This case was approved and followed, as to the wages of employees during the six months immediately preceding the receiver's appointment, in Union Trust Co. *v.* Illinois Midland Ry. Co. (1886), 117 U. S. 434; and as to freight balances, in Finance Co. of Pennsylvania *v.* Charleston, C. & C. R. Co. (1895), 10 C. C. A. 323; 62 Fed. Rep. 205; 61 Am. & Eng. R. R. Cas. 710. In this last case the issue of first-lien certificates to meet these, as well as some other obligations, had been authorized, and the trustee had raised no objection. The circumstances, therefore, raised a sort of estoppel against the bondholders, but the general principle is approved unreservedly by the court.

[5] Union Trust Co. *v.* Illinois Midland Ry. Co. (1886), 117 U. S. 434. See further as to notice to parties in interest, Chap. XXXI.

preservation of the property, and cannot be made a prior lien thereon without the consent of the mortgage creditors. "It clearly ought not to have been assumed," said the court, "that the ordinary agencies of the law were inadequate to the situation, or that the law, operating through its regularly appointed channels, was impotent to control it."[1]

§ 616. **Assumption of Floating Indebtedness by Purchasers does not create Lien, etc.** — The assumption by a purchasing company of the floating indebtedness of two other companies does not create a lien upon the property transferred in favor of the creditors to whom that indebtedness is owing. By such a transaction those creditors merely acquire the right of looking for payment to the purchasing as well as to the vendor companies.[2]

§ 617. **Back Claims not Lien on Corpus, because Income of Receivership insufficient to pay them.** — The fact that the income of the receivership is insufficient to discharge the back claims specified in the order of appointment will not justify the court in providing for their payment by declaring them to be a lien on the *corpus*. As was said in Burnham *v.* Bowen, "We do not now hold, any more than we did in Fosdick *v.* Schall, that the income of a railroad in the hands of a receiver can be taken away from the mortgage creditors and used to pay the general creditors of the road. All we then decided, and all we now decide, is, that if current earnings are used for the benefit of mortgage creditors before current expenses are paid, the mortgage security is chargeable in equity with the restoration of the fund which has thus been improperly applied to their use."[3]

§ 618. **Preferential Debts of any Part of Composite System a Charge on whole Property.** — Where the receiver is appointed in a suit to foreclose a general mortgage on a composite system of roads operated by a single corporation, the preferential debts of the corporation will be charged on the earnings of the entire

[1] Raht *v.* Attrill (1887), 106 N. Y. 423, 434; s. c. 13 N. E. Rep. 282. Much stress was laid by the court on the fact that such a company is not a *quasi* public character like a railroad company, and Miltenberger *v.* Logansport Ry. Co., *supra*, was distinguished on this ground. But it is submitted that the doctrine of that case would not have warranted any different decision if the company had been operating a railroad instead of a hotel. The necessity of "preserving" the railroad, which was the basis of the ruling of the United States Supreme Court, had no reference to its preservation from physical violence, but only to its preservation from the damage to the business and to the public interest which would have resulted from the receiver's suddenly being deprived of the whole or a large part of the persons engaged in operating the road.

[2] Hervey *v.* Illinois Midland Ry. Co. (1884), 28 Fed. Rep. 169.

[3] 111 U. S. 776; s. c. 17 Am. & Eng. R. R. Cas. 308 (1884).

system. These debts being the obligations of a single debtor, it makes no difference whether they were incurred in the operation of one line or of the other. The fact that some of those lines are yielding a surplus income, and others are not paying their expenses, does not constitute a reason for saddling the whole burden of such debts on the non-paying lines. Hence the bondholders secured by prior underlying mortgages on the paying lines have no equity to demand that the payment of the preferential debts and operating expenses of the non-paying lines out of the earnings of the receivership shall be treated as a diversion of such earnings, entitling them to have interest on their bonds declared a first charge on the *corpus* of the whole property, if the earnings themselves are insufficient to satisfy their claim.[1]

§ 619. **Doctrine of Diversion not applicable to Ordinary Creditor's Suit.** — The doctrine which permits a lien to be fastened on the proceeds in favor of certain classes of creditors, where the current earnings have been diverted for the benefit of the bondholders, has no application to a case where a receiver is appointed in an ordinary creditor's suit in aid of a judgment obtained for an unsecured debt, especially where the claim of the complainant is as meritorious as that of the other creditors who ask to be allowed to share ratably with him in the proceeds. To such a case the ordinary rule is applicable, that, where the aid of a court of equity is sought by judgment creditors to reach property that cannot be reached by legal proceedings, the court follows the law, and recognizes the priority which those judgment creditors who have moved in the cause would have obtained by the levy of an execution at the time of filing the bill, if no obstacles had stood in the way of the levy.[2]

[1] Central Trust Co. *v.* Wabash, St. Louis, & Pac. Ry. Co. (1887), 30 Fed. Rep. 332.

Where the receiver appointed by a district judge in one State of a railroad running through two States is also appointed receiver of its property in the other State, and there is some variance in the orders of these courts as to the procedure and administration of the receiver made by the two judges, each making such orders in the matter as are made in his ordinary practice, the difference not affecting any substantial rights of the parties, the circuit judge will not interfere or modify such orders.

"The court where the bill is filed and the receiver first appointed is the court of primary administration, and in the other the administration is merely *ancillary.* Yet the rights of all the parties go back to the statutes of the two States, and although the corporation is a single consolidated corporation, yet its rights in each of the States must largely be affected by the statutes, and the course of the decision and procedure therein. This difference in the origin and source of rights may naturally affect many matters of procedure in the administration of the property, and it cannot be held that such procedure must in all cases be made uniform in the two States." Central Trust Co. *v.* Texas & St. Louis R. Co. (1884), 22 Fed. Rep. 135.

[2] George *v.* St. Louis Cable & W. Ry. Co. (1890), 44 Fed. Rep. 117.

ARTICLE III. — WITHIN WHAT PERIOD BACK CLAIMS MUST HAVE ACCRUED TO BE ALLOWED PREFERENCE. THE SIX MONTHS' RULE.

§ 620. **Generally.** — In the absence of special considerations, the courts are disinclined to allow any back claims to rank as preferred debts, unless they have accrued within six months prior to the appointment of a receiver. This period was fixed originally, as it seems, with reference to statutes *in pari materia.*[1]

In a foreclosure action by the trustee representing bondholders of a corporation mortgage, the preference given under the Iowa statute (Acts 23d Gen. Ass., ch. 48) to laborers or servants, for wages due for three months previous to a receivership, was recognized as against the claims of the trustees of the mortgage and their attorneys, as well as the holders of the bonds secured by

[1] Thus in Scott *v.* Clinton & Springfield R. Co. (1876), 6 Biss. 529, 535; s. c. 21 Fed. Cas. 820, Case No. 12,527, decided in the Circuit Court of the Southern District of Illinois, Judge Drummond said: "We have, as a sort of necessity of the case, and yielding to some extent to the statute of this State, where supplies and materials have been furnished to a railroad, and the diligence required by the statute has been used by the creditors to enforce their claims within six months, allowed the payment of those claims." The statute here referred to was enacted in 1872, and gave a lien upon railroad property of all kinds for "fuel, ties, materials, supplies, or any other article or thing necessary for the construction, maintenance, operation, or repair of such roads by contracts with such corporation," and for "work and labor for such construction, maintenance, operation, or repair, by the like contract," as part of the current expenses of the road, "as against such railroads, and as against all mortgages or other liens which shall accrue after the commencement of the delivery of said articles or the commencement of said work or labor," and also provided that "suit should be commenced within six months after the completion of the contract, the performance of the labor, or furnishing the materials." Starr & Curtis Annotated Stat. of Ill., p. 1533.

In a later case, Turner *v.* Indianapolis, B. & W. R. Co. (1878), 8 Biss. 315, the same judge explained at greater length the reasons which led him to refer to this statute for guidance in determining what would be a suitable time limit under such circumstances. "It being conceded that some claims for past services should be paid, the next point to be determined was, what limitation, if any, as to time, should be placed upon such payment. It was found in many cases that those who had control of the railways, instead of paying the current operating expenses of the companies, would postpone the payment of the same sometimes for many months in favor of the interest due on the mortgages, which they would discharge, in the hope, apparently, that a more favorable time in the business of the roads would enable them to make up the deficiency. It was in view of this and similar considerations, growing out of the actual condition of affairs, and of the absolute necessity of fixing some reasonable time within which such claims should be allowed, that the court adopted, as by analogy, the rule of the statute of Illinois in relation to liens on railroads for work done and supplies and materials furnished.

the mortgage; but the court held that the fees of the receivers and their attorneys were a part of the costs of the case, and were properly allowed a preference, as also a balance due on a loan authorized by the court and made by a receiver for carrying on the business of the corporation and payment of wages due prior to the receivership.[1] But the true test is that the debt should have been contracted in the ordinary course of a continuing business, to be paid out of current earnings, and within such a period that it would, presumably, have been paid at the time agreed upon if the company had remained in possession.[2]

When debts of this character remain unsettled, or are not put in suit for such a time as would be deemed unreasonable, it may fairly be presumed that the creditors have ceased to look to current receipts for payment, and have accepted the position of general creditors, who, as such, would have no claim for indemnity upon any special part of the income.[3]

§ 621. **The Six Months' Rule.** — The choice of the limit of six months in the class of cases referred to has been sufficiently regular to have given rise to the familiar expression, "The Six Months' Rule;" but, as a matter of fact, no absolute rule has ever been established.[4] See § 598, *ante*.

Thus preference has been given to claims antedating the ap-

[1] St. Paul Title Ins. & Trust Co. *et al.* *v.* Diagonal Cove Co. *et al.* (Gunson *et al.*, Interveners) (1895), 64 N. W. Rep. 606.

In Mellon *et al.* *v.* Morristown & Cumberland Gap R. Co. *et al.* (Tenn., 1895), 35 S. W. Rep. 404, persons loaning money to contractors, with which they may have paid for rails, etc., to be used in the construction of the road, without a special contract to that effect, could have no lien for their money loaned, nor could they be subrogated to the liens which the furnishers of such supplies could have.

[2] Burnham *v.* Bowen (1884), 111 U. S. 776; s. c. 17 Am. & Eng. R. R. Cas. 308.

[3] Thomas *v.* Peoria & R. I. R. Co. (1883), 36 Fed. Rep. 808; s. c. 36 Am. & Eng. R. R. Cas. 381. In this case Mr. Justice Harlan ruled that, *in the absence of special circumstances*, the income accruing during the receivership would not be chargeable for rents of cars, etc., accruing more than six months before the appointment of the receiver. In Manchester Locomotive Works *v.* Truesdell (1890), 44 Minn. 115, the court sustained the disallowance of a claim for the price of a locomotive, principally on the ground that the sale was completed more than six months before the appointment of the receiver, — holding that the designation of a time limit was a matter within the discretion of the court.

[4] In Blair *v.* St. Louis, H. & K. R. Co. (1884), 22 Fed. Rep. 471, Judge Brewer, while conceding that, in his opinion, a period of six months was ordinarily ample, added: "There is no arbitrary time prescribed, and it should be only such reasonable time as, in the nature of things, and in the ordinary course of business, would be sufficient to have such claims settled and paid." So also in Fidelity Co. *v.* Shenandoah R. Co., Va., 9 S. E. Rep. 759.

pointment of a receiver by eight months;[1] by eleven months;[2] by two years;[3] by three years.[4]

The date at which supplies were actually furnished is the material point in determining whether the debt therefor is to be preferred. Hence a clause in the order appointing a receiver, whereby he is authorized "to pay the amounts due and maturing for materials and supplies about the operation and use of said road," does not warrant the payment of a renewed promissory note, originally made by the company in payment of a claim for re-rolling iron for the use of the road some years before.[5]

The claim of a steel company for coupling links and pins and tank steel necessary to the operation of a railroad from day to day, furnished within four months before the appointment of a receiver in a foreclosure suit of the first mortgage and within a year before the receivership was extended to a suit to foreclose the second mortgage, was given a prior lien to the mortgages in the United States Circuit Court for the District of Massachusetts.[6]

§ 622. **Rule where there is a Running Account.** — If, at the beginning of the six months, there is an open and running account for supplies, all the items will be given preference if the account is under a subsisting contract; otherwise all the items previous to that time will be disallowed.[7]

§ 623. **Unsecured Claims antedating Period fixed in Order, Payment of.** — Unsecured claims antedating the period fixed in the order may be paid out of any surplus earnings that may remain in the hands of a receiver after paying the claims specially provided for, but not out of the *corpus*.[8]

[1] Skiddy *v.* Atlantic, Miss. & Ohio R. Co. (1879), 3 Hughes, 320; Douglass *v.* Cline (1877), 12 Bush (Ky.), 608.

[2] Burnham *v.* Bowen (1884), 111 U. S. 776.

[3] Williamson *v.* Washington City, Va. Midl. & Grt. Southern R. Co. (1880), 33 Gratt. 624; Farmers' Loan & Trust Co. *v.* Kansas City, W. & N. W. Ry. Co. (1892), 53 Fed. Rep. 182; Central Trust Co. *v.* St. Louis, A. & T. Ry. Co. (1890), 41 Fed. Rep. 551. In this last case the court refused to be governed by the lien law of the State, which required a supply creditor to take steps to enforce his claim under the law within one year after it accrued.

[4] Hale *v.* Frost (1878), 99 U. S. 389. In this case a note had been given for the debt sixteen months prior to the receiver's appointment, but it does not appear that any stress was laid on this fact.

[5] Brown *v.* New York & Erie R. Co. (1860), 19 How. Pr. (N. Y.) 84.

[6] Wood *v.* New York & New England R. Co. *et al.* (Carnegie Steel Co., Lim., Intervener), (1895), 70 Fed. Rep. 741. After discussing the cases pertinent to the question, Colt, C. J., said: "As to the objection that these supplies were not furnished during the period of time within which alone a priority can be given, it may be said that there is no fixed rule as to time further than is expressed by the words "reasonable time."

[7] Central Trust Co. *v.* Texas & St. Louis Ry. Co. (1885), 23 Fed. Rep. 673.

[8] This doctrine was announced with some hesitancy in Bayliss *v.* Lafayette M.

ARTICLE IV. — CLASSES OF BACK CLAIMS ENTITLED TO PRIORITY.

§ 624. **Generally.** — The underlying principle in the cases where debts arising before the receivership have been allowed as prior in equity to the claim of the bondholder on the earnings during the receivership, has, in one case, said to be that "the debt, when incurred, operated in a direct way to the advantage of the bondholder." [1]

In another case, the proper test has been declared to be whether or not the claim falls into the category of "payments made to preserve the estate." [2]

These *dicta* appear to be merely two ways of stating the same doctrine, though, if strictly construed, the latter statement would obviously circumscribe preferred debts within somewhat narrower limits than the former. In another case, Judge Brewer thought that "whatever is necessary in the ordinary administration of the affairs of the corporation comes within the spirit of the decisions" of the Supreme Court of the United States. If by "necessary" is meant necessary for the preservation of the road as a going concern, this theory of the proper limits of preferred debts does not differ materially from the other two.[3]

The effect of the three *dicta* just cited may perhaps be stated thus: To give a claim the status of a preferred debt, it must represent not merely a liability contracted in carrying on the business, but a liability which in a reasonable sense it was necessary to incur in order to keep the road in operation. The following sections will show in detail what precise claims are and are not included in the favored class.

The receiver of a company, no more than the company itself, can raise the question of the constitutionality of an act of a State

& B. R. Co. (1879), 9 Biss. 90; s. c. 2 Fed. Cas. 1080, Case No. 1141; 8 Rep. 579, by Judge Drummond. But in United States Trust Co. *v.* New York, W. S. & B. R. Co. (1885), 25 Fed. Rep. 800, Judge Nixon, of the New Jersey Circuit, declared that, if there had been any surplus available, he would not have hesitated to order the payment of the claim of a supply creditor which accrued before the commencement of the privileged period; while in a recent case the broad rule was laid down by the Circuit Court of Appeals "that a six months' limitation, in an order of appointment upon the payment of claims for supplies, has no effect in barring meritorious preferential claims." Northern Pacific R. Co. *v.* Lamont (C. C. A., 1895), 69 Fed. Rep. 23.

[1] Easton *v.* Houston & Texas Central Ry. Co. (1889), 38 Fed. Rep. 12, per Pardee, J.

[2] Frazier *v.* East Tennessee, Va. & Ga. R. Co. (1889), 88 Tenn. 138; s. c. 12 S. W. Rep. 419; 40 Am. & Eng. R. R. Cas. 358.

[3] Blair *v.* St. Louis, H. & K. R. Co. (1885), 23 Fed. Rep. 521.

affecting the right of a claimant to have his debt preferred as a lien under such act, upon the ground that the statute discriminates against citizens of other States.[1]

Where net earnings of a railroad have been irrevocably assigned to bondholders, claimants of prior liens upon the gross earnings of the company, who have let payment be made to the bondholders first, will not be entitled to have payment made to them as against the bondholders out of income accruing after a receiver has been appointed.[2]

[1] Brown *v.* Ohio Valley Ry. Co. (1897), 79 Fed. Rep. 176, in which case the statute of Indiana, 2 Burns' Rev. St. Ind. 1894, § 5179, giving citizens of the State a lien on the personal property of railroad companies to the amount of $100 for all debts originally contracted in the State superior to all other liens and mortgages, has been held in the federal courts valid as against a railroad company and other holders of liens.

Judgment creditors of a company in the possession of receivers derive no vested right to have their claims settled in full from an order of the court authorizing the receivers "to compromise, adjust, and settle in their best discretion" claims against the company. Mercantile Trust Co. *v.* Baltimore & O. R. Co. (1897), 79 Fed. Rep. 389.

A judgment against a company growing out of a negligence of its servants was denied a preference in Farmers' Loan & Trust Co. *v.* Northern Pac. R. Co. (1897), 79 Fed. Rep. 227.

A claim for rental of terminal facilities, especially for the time they were used by the receiver, has been accorded a preference over the mortgage in Savannah, F. & W. Ry. Co. *v.* Jacksonville, T. & K. W. Ry. Co. (1897), 79 Fed. Rep. 35.

Claims for amounts of money expended in repairs of a leased road which was a part of the system, and the payments of interest on the bonds of the lessor, which had been guarantied, have also been given preference to the mortgage bondholders' claims. Southern Ry. Co. *v.* Fillett (1896), 76 Fed. Rep. 507.

A case where the receiver used portions of the income, under the orders of the court for the betterment of the property and the claims of creditors, were given preference over the trustee of the mortgage. Manhattan Trust Co. of New York *v.* Seattle Coal & Iron Co. (Wash., 1897), 48 Pac. Rep. 333.

The rule as to the lien of a vendor of chattels which have become a part of the realty is stated in New York Security & Trust Co. *v.* Capital Ry. Co. (1896), 77 Fed. Rep. 529.

[2] Grand Trunk Ry. *v.* Central Vermont R. Co. (1897), 78 Fed. Rep. 690.

A mortgagor corporation sold land lots, which it had previously mortgaged to B., to a street-railway company, which erected a power-house on them and used them for railroad purposes. A receiver was subsequently appointed for the company in a suit against it, and, to pay operating expenses, receiver's certificates were issued. A sale of the company's property, including the land lots, was made at the request of the holders of these certificates, and the proceeds applied to their payment. B., though cognizant of these proceedings, was not a party to the suit. Interest on his mortgage and taxes on the lots had been paid by the receiver during his possession of the property. B.'s right to foreclose his mortgage after these proceedings was sustained in Third Street Suburban Ry. Co. *v.* Lewis (1897), 79 Fed. Rep. 196.

The holders of certain "debentures" or bonds, secured by a mortgage upon certain lands of the company, were held to have a priority over the original vendor's liens on those lands to which an intervener attempted to have himself subrogated, in Blake *v.* Pine Mountain Iron Co. (1896), 76 Fed. Rep. 624.

§ 625. **Debts for Freight and Ticket Balances.** — Debts for freight and ticket balances in favor of other companies are always allowed.[1]

§ 626. **Debts incurred in the Transportation of Passengers and Freight.** — In Dow *v.* Memphis & Little Rock R. Co., Judge Caldwell required the payment of this class of obligations as a condition of appointing a receiver, but it is not apparent from the report what precise items were included amongst them. They are mentioned separately from ticket and freight balances.[2]

§ 627. **Debts for Wages due Employees.** — The general propriety of allowing a preference to these is not disputed.[3]

But some discussion has taken place as to whether all persons who have rendered services of any description are entitled to a preference. Perhaps the better opinion is that the rule avails in favor of all classes of employees, whether their work is mainly mental or mainly physical. In Farmers' Loan & Trust Co. *v.* Vicksburg & Meridian R. Co.,[4] the effect of the authorities was said to be that the wages and salaries of employees of every grade should be placed among the preferred debts.

In one of the earlier cases priority was allowed to a claim for services rendered as counsel,[5] and a similar ruling has been made by Judge Brewer.[6]

[1] Miltenberger *v.* Logansport Ry. Co. (1882), 106 U. S. 286, 311; s. c. 12 Am. & Eng. R. R. Cas. 464; Union Trust Co. *v.* Illinois Midland Ry. Co. (1886), 117 U. S. 434; Farmers' Loan & Trust Co. *v.* Kansas City, W. & N. W. Ry. Co. (1892), 53 Fed. Rep. 182; Farmers' Loan & Trust Co. *v.* Vicksburg & Meridian R. Co. (1888), 33 Fed. Rep. 778; Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 260; s. c. 17 Am. & Eng. R. R. Cas. 324.

[2] 20 Fed. Rep. 260; s. c. 17 Am. & Eng. R. R. Cas. 324 (1884). This case, however, is supposed to be one of those which the Supreme Court of the United States had in mind when it reprimanded the judges who had gone to the length of requiring the payment of *all* unsecured debts (Kneeland *v.* American Loan & Trust Co., § 605, *ante*); and any ruling for which it is the sole authority should perhaps be regarded as at least open to controversy.

[3] Duncan *v.* Trustees (1876), 9 Am. Ry. Rep. 386; Douglass *v.* Cline (1877), 12 Bush (Ky.), 608; s. c. 18 Am. Ry. Rep. 273; Fosdick *v.* Schall (1879), 99 U. S. 235; Miltenberger *v.* Logansport Ry. Co. (1882), 106 U. S. 286; s. c. 12 Am. & Eng. R. R. Cas. 464; Union Trust Co. *v.* Illinois Midland Ry. Co. (1885), 117 U. S. 434; Dow *v.* Memphis & C. R. Co. (1884), 20 Fed. Rep. 260; s. c. 17 Am. & Eng. R. R. Cas. 324.

[4] 33 Fed. Rep. 778 (1888).

[5] Bayliss *v.* La Fayette, M. & B. Ry. Co. (1879), 9 Biss. 90; s. c. 2 Fed. Cas. 1080, Case No. 1141; 8 Fed. Rep. 579.

[6] Blair *v.* St. Louis, H. & K. R. Co. (1885), 23 Fed. Rep. 521. In this case the allowance was limited to the instalment of the salary which became due just before the appointment of the receiver. The learned jndge declined to recognize the priority of a claim for services which accrued a year and a half previously, remarking: "While, of course, as we in the profession all agree, lawyers are benefactors to the human race, and entitled to special consideration at the hands of any intelligent tribunal, yet I think that a

So, also, it has been held in New York, though by a divided court, that such services were included in an order directing the payment of debts "owing to the laborers and employees of the company for labor and services actually done in connection with the company's railways."[1]

If the general term "employees" is alone used in the order, there seems to be no reason why the regular counsel of the company should not have the benefit of its provisions.[2]

This is assumed to be the rule in one case, the court, however, holding that the special lien of such a counsel would be allowed a priority only as to the income of the receivership, and as to the company's papers and muniments of title which he had in his possession, and would not be recognized as extending to the general *corpus* of the estate.[3]

On the other hand, in Addison *v.* Lewis,[4] the court was strongly of opinion that the salary of the president of the company was not a preferential claim; but the actual ground on which his claim was disallowed was that he had waived his rights by stating in the annual reports of the company's business that his salary was one of the items paid.

A secretary of a railroad company has no priority of lien to the bondholders for services rendered the company within six months prior to the receivership.[5]

It has also been ruled that the term "wages of employees," in an order instructing the receiver as to the claims to be paid in preference to the mortgage debt, did not include the money due for the services of a counsel employed for special purposes.[6]

lawyer who waits a year and a half before collecting his fees is guilty of great negligence. He certainly presents no equitable claims for preference."

[1] Gurney *v.* Atlantic & Great Western R. Co. (1874), 58 N. Y. 358.

[2] In Louisville, Evansville, & St. Louis R. Co. *v.* Wilson (1891), 138 U. S. 501, 505, this question was incidentally touched upon. The court declined to express any decided opinion, as the point was not directly involved, and the case went off on a special ground.

[3] Bound *v.* South Carolina R. Co. (1892), 52 Fed. Rep. 526.

[4] 75 Va. 701; s. c. 9 Am. & Eng. R. R. Cas. 702 (1881).

[5] Central Trust Co. of New York *v.* Chattanooga S. R. Co. (Harris, Intervener), (1895), 69 Fed. Rep. 295. The court distinguished Fosdick *v.* Schall (1879), 99 U. S. 235, and Cutting *v.* Tavares, O. & A. R. Co., 61 Fed. Rep. 150; s. c. 9 C. C. A. 401 (1894).

This last case held that, in order to make such a claim preferential, it must appear that there was an order of court at the time the receivers were appointed providing for its payment, and evidence that the current earnings before or after the appointment of the receivers were diverted to paying interest on the bonded debt. Neither of these facts were shown in the petition of Harris.

[6] Louisville, Evansville, & St. Louis R. Co. *v.* Wilson (1891), 138 U. S. 501. Gurney *v.* Atlantic & Great Western Ry. Co., *supra*, was cited, but held not to be strictly in point. The court declined to pass any criticism on that decision, being

The construction placed upon the statutes which have created legal priorities similar in character to those recognized by courts of equity is rather in favor of this stricter interpretation. Thus the Vermont statute makes a mortgage of railroad chattels inoperative against claims "for injuries sustained on the road by reason of the neglect of the corporation, or for services rendered or materials furnished for the purpose of keeping the road in repair, or in running the same." Its protection has been declared to extend to creditors who are engaged in manual labor in making repairs or in operating the roads, or who have furnished materials to be used therein, as iron, ties, etc., but not to claims for services of directors, superintendents, civil engineers, cashiers, paymasters, or heads of departments, nor to claims for rents of offices occupied by them, nor to claims for telegraphing ordered by them, nor to claims for the printing of tickets, bill-heads, posters, time-tables, etc., and the materials used therein.[1]

Since the *rationale* of the rule allowing debts for wages of employees to be preferred to the mortgage debt is that it would be unreasonable as well as detrimental to the operation of the road to expect them to make careful examination into the financial condition of the company, and that they should therefore be encouraged to continue working by the assurance that the court will provide for any claims of this description accruing a reasonble time before the receiver's appointment, it has been held that, as the president of the company has full knowledge of the state of its affairs, and is not bound to furnish his services a day after his remuneration seems uncertain, he is not entitled to priority of payment, as to the arrears of his salary, out of the proceeds of the sale, where the earnings are insufficient to pay even the receiver's compensation.[2]

§ 628. **Claims for Legal Services not preferred unless they have inured to Benefit of Bondholders.** — A claim for legal services in advising parties who have lent money to keep the road in operation to secure themselves by taking assignments of preferential claims, which upon foreclosure are recognized, and obtain for the lenders an equality of right with the security holders in a reorganization scheme, is not entitled to a priority over the mortgage debt. Funds belonging to the mortgagee cannot be taken from

apparently of opinion that the special circumstances of the case had largely influenced the inclusion of professional services within the descriptive words of the appointment.

[1] Poland *v.* Lamoille Valley R. Co. (1879), 52 Vt. 144.

[2] National Bank of Augusta *v.* Carolina, K. & W. R. Co. (1895), 63 Fed. Rep. 25.

him to pay counsel to devise a scheme by which a subsequent lender of money is preferred before him.[1]

Nor are security holders liable for the expenses incurred by their debtor in carrying into effect a scheme which the latter believes will enable it to pay its interest to them, but which in fact does not accomplish that result. Hence services rendered by counsel at the instance of a railroad company to preserve control of the portion of its road which is not covered by the mortgage under foreclosure cannot be considered as services to the holders of bonds secured by that mortgage.[2]

On the other hand, services of counsel in recovering some of the mortgagor's property from a company which has the same, and thereafter passed into a receiver's hands, inure to the benefit of the secured creditors of the lessor company, and are properly charged against the assets of the latter as a preferential claim.[3]

The funds in the hands of a receiver appointed in a suit to foreclose a mortgage executed by one who purchased the railroad at a sale in earlier proceedings are not chargeable with a claim for legal services to another receiver who administered the property prior to that sale, even though the services resulted in reducing the demand of a lienholder, and to this extent inured to the benefit of the bondholders secured by the second mortgage.[4]

§ 629. **Debts for Supplies and Materials.** — Debts for supplies and materials furnished for equipping, operating, repairing, or improving the road are indisputably in the preferred class.[5]

[1] Louisville, Evansville, & St. Louis R. Co. *v.* Wilson (1891), 138 U. S. 501.

[2] Ibid.

[3] Louisville, Evansville, & St. Louis R. Co. *v.* Wilson (1891), 138 U. S. 501, citing Read *v.* Dupper, 6 T. R. 361. "The principle has long been settled that a party should not run away with the fruits of a cause without satisfying the legal demands of his attorney by whose industry and expense these fruits were obtained."

[4] Bound *v.* South Carolina Ry. Co. (1892), 51 Fed. Rep. 58, citing Hand *v.* Savannah & Charleston R. Co. (1883), 21 S. C. 162, to the effect that "before a legal charge can be sustained there must be a contract of employment, either expressly made or superinduced by the law on the facts."

[5] Fosdick *v.* Schall (1879), 99 U. S. 252; Burnham *v.* Bowen (1884), 111 U. S. 776; Farmers' Loan & Trust Co. *v.* Vicksburg & Meridian R. Co. (1888), 33 Fed. Rep. 778; Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 260; s. c. 17 Am. & Eng. R. R. Cas. 324; Williamson *v.* Washington City, Va. Midl. & Grt. Southern R. Co. (1881), 33 Gratt. 624; s. c. 1 Am. & Eng. R. R. Cas. 498. In Skiddy *v.* Atlantic, Miss. & Ohio R. Co. (1878), 3 Hughes, 320, where no conditions had been imposed at the appointment of the receiver, the court refused to accord priority to the claims of material-men, and declined to attach any importance to the fact that these claims were made under contracts just before the commencement of the proceedings, and that the material had been used by the receivers. "Whether a debt be an hour or a year old," said Judge Bond, "can make no difference. It stands in the same relation, no matter what its age, to the secured debt of the road. To allow one of these debts to be

The rule is the same whether the supplies were upon a contract with the company owning the road, or another company having possession of it and operating it under the obligation of paying the current expenses.[1]

In the category of necessary supplies may be placed waiting-rooms and ticket-offices at any point where the business requires such accommodation.[2]

§ 630. **Debts for Materials or Equipments furnished on Credit not preferred.** — The general principle applicable to indebtedness incurred under a specific contract for supplies, which contemplates payment at some definite period or periods in the future, is that the seller thereby surrenders the favored position of a preferred creditor, and is only entitled to come in as an unsecured claimant, except in so far as he may have reserved a lien on the articles sold.[3]

The case of such a claimant is declared to be very different from that of workmen and employees, or of those who furnished from day to day supplies necessary for the maintenance of the road.[4]

paid is to allow all. That is to say, the unsecured debt would be paid *pari passu* with the secured debt, and in a court of equity it would come to pass that the only persons who had no security would be those who had taken it." But this decision is, in view of its date, chiefly interesting as a clear statement of what the rule was considered to be before Fosdick *v.* Schall.

[1] Clark *v.* Central Railroad & Bkg. Co. (C. C. A., 1895), 66 Fed. Rep. 803.

[2] Northern Pacific R. Co. *v.* Lamont (C. C. A., 1895), 69 Fed. Rep. 23.

All claims for supplies contracted within a reasonable time before a receiver comes into possession of earnings of a company must be paid before any of the earnings is applied to betterments or interest on bonds. Southern Ry. Co. *v.* Carnegie Steel Co. (1896), 76 Fed. Rep. 492; Southern Ry. Co. *v.* American Brake Co. (1896), 76 Fed. Rep. 502. If earnings have been diverted, then they must be paid out of the proceeds of sale of the property. Ibid. A claim for current supplies, when approved by the acceptance of a draft for the amount by a receiver, should also be paid from such proceeds under similar circumstances. Southern Ry. Co. *v.* Adams (1896), 76 Fed. Rep. 504. But after accepting from the receivers the principal of such a claim, the owner cannot re-petition for interest. Southern Ry. Co. *v.* Dunlop Mills (1896), 76 Fed. Rep. 505. As to what is a reasonable time within which supplies may have been acquired before the receivership to give them an equitable priority, a claim for steel rails supplied from nine to eleven months prior to receivership was held, in Southern Ry. Co. *v.* Carnegie Steel Co. (1896), 76 Fed. Rep. 492, not lost by laches, as notes were made in renewal of the claim, and the amount was demanded promptly at their maturity. Bound *v.* South Carolina Ry. Co., 58 Fed. Rep. 473, was distinguished by the court.

[3] Bound *v.* South Carolina Ry. Co. (C. C. A., 1893), 58 Fed. Rep. 473; American Loan & Trust Co. *v.* East & West R. Co. (1891), 46 Fed. Rep. 101.

[4] Thomas *v.* Western Car Co. (1893), 149 U. S. 95.

Where a company bargained for steel rails in large quantities, for the purpose of replacing old worn-out rails, upon a contract that notes were to be given for the amount at six months, with privilege of renewal for another six months, such a debt was held not entitled to preference over the mortgage. Lackawanna Iron &

The most common illustration of this principle is furnished by the cases in which there has been a conditional sale of rolling-stock for a price to be paid in instalments, the title remaining in the vendor till payment of the last instalment. The amounts due under such a contract are not preferential debts. The vendor has a priority to the extent of his lien, and may enforce it by taking back the rolling-stock, if the instalments of the purchase-money are not duly paid; but as to the balance of what is due to him after enforcing his lien, he is a general creditor, with no special equities in his favor.[1]

It is immaterial for the purposes of this rule whether the sums of money stipulated to be paid at the specified intervals are styled in the contract instalments of the price, or rent.[2]

The same principle is also held to govern cases where the contract is in fact, as well as in name, a lease, and the remedy

Coal Co. *v.* Farmers' Loan & Trust Co. (1897), 79 Fed. Rep. 202, followed in Morgan's La. & Tex. R. & St. Ship Co. *v.* Farmers' Loan & Trust Co. (1897), 79 Fed. Rep. 210, where a claim was made for money loaned, etc.; also in Southern Development Co. *v.* Farmers' Loan & Trust Co. (1897), 79 Fed. Rep. 212, relating to a claim for money advanced for certain purposes.

[1] Fosdick *v.* Schall (1879), 99 U. S. 235; s. c. 7 Rep. 449; Huidekoper *v.* Hinckley Locomotive Co. (1879), 99 U. S. 258; Fidelity Insurance, Trust, & Safe Deposit Co. *v.* Shenandoah Valley R. Co. (1889), 86 Va. 1; s. c. 9 S. E. Rep. 751; 38 Am. & Eng. R. R. Cas. 559; Frank *v.* Denver & Rio Grande Ry. Co. (1885), 23 Fed. Rep. 123, 127. See also Eastern and Midlands Ry., 65 Law Times, 670.

[2] Kneeland *v.* American Loan & Trust Co. (1890), 136 U. S. 89, 97; s. c. 43 Am. & Eng. R. R. Cas. 519. In this case the question was presented nakedly, without being complicated by any special circumstances, the appointment of the receiver being at the instance of a judgment creditor, and solely with a view of reaching the surplus earnings. The mortgagees had not asked for a foreclosure, nor that the court should take charge of the property, and the owners of the rolling-stock had reclaimed it, as in Fosdick *v.* Schall. Only the property was sold which was covered by mortgages executed prior to any contract with respect to the rolling-stock, so that the owners of it were precluded from averring that their property was sold, and that this gave them an interest in the sale.

It was emphatically declared that, under these circumstances, there was no foundation whatever upon which to rest a claim for priority of payment out of the proceeds of the sale of the property in foreclosure proceedings afterwards instituted by the mortgagees, Mr. Justice Brewer taking occasion to deliver a strong protest against the extreme instances of the assumption of discretionary power by some courts in respect to the preference of unsecured debts.

As to preference to mortgage of car rentals where the receiver has retained and used cars leased by the company, see Mercantile Trust & Deposit Co. *v.* Southern Iron Car Line Co. (Ala., 1897), 21 So. Rep. 373.

As to preference over mortgage of claims for receiver's certificates, see Boston Safe Deposit & T. Co. *v.* Holders of $130,500 of Receiver's Certificates (1896), 75 Fed. Rep. 193; Boston Safe Deposit & T. Co. *v.* Groome (1896), 75 Fed. Rep. 209.

When a debt for rental of a leased line, part of a system, shall be treated as an obligation of the receivership, authorized by the court, see Central R. & Bkg. Co. of Georgia *v.* Farmers' Loan & Trust Co. (1897), 79 Fed. Rep. 158.

reserved by the lessor is a right to terminate the contract and demand possession of the cars forthwith upon any failure of the railroad company to pay promptly the interest or principal of any of its bonds or other liabilities. Such a provision shows that the lessor intended to protect himself by other methods than relying on the possible order of a court which might appoint a receiver. The reasons for adopting this conclusion are of course much stronger where the lessor is a car company, the principal officers of which control the railroad company also. Having full knowledge of the financial condition of the railroad company, they must be treated as having leased the cars to it in reliance on its general credit, rather than in expectation of displacing the priority of the mortgage lien.[1]

This general principle avails in favor of the mortgagee even as to the period during which the property is controlled by a receiver, provided the receiver is not appointed at his own instance. The relative priorities of the liens of the mortgagees and of the vendor of rolling-stock under a conditional sale are not affected by the appointment of a receiver to enforce the claims of a third party. Since neither lienholder has, in such a case, asked the aid of the court, no obligation is assumed by either in respect to the management of the property. The use of the rolling-stock by the receiver for several months, therefore, can give its owners no right to charge upon the mortgage estate the deficiency that may remain after the application of the current income to the payment of the rental.[2]

Claims for rental of cars during receivership, which cars the receiver has retained, and the trustee of bondholders has resisted being delivered to a lessor, reserving title, are properly chargeable to the proceeds of sale of the property, as expenses of administration to be preferred to the claims of bondholders.[3]

These rules as to equities in the matter of a receiver's using cars held by the railroad company under a lease have been declared by the Supreme Court of Georgia: —

(*a*) The time for which the rental of the cars is chargeable to the assets of the railway company is obviously that during which the company and its receiver had possession of and used them.

[1] Thomas *v.* Western Car Co. (1892), 149 U. S. 95, 110, reversing on this point Thomas *v.* Peoria & R. I. R. Co. (1888), 36 Fed. Rep. 808; s. c. 36 Am. & Eng. R. R. Cas. 381.

[2] Kneeland *v.* American Loan & Trust Co. (1890), 136 U. S. 89; s. c. 43 Am. & Eng. R. R. Cas. 519.

[3] Lane, Receiver, *v.* Macon & Atlantic Ry. Co. *et al.* (1895), 96 Ga. 630; s. c. 24 S. E. Rep. 157.

(*b*) As a general rule, compensation for the ordinary wear and tear of a thing rented is included in and covered by the rental charge. . . . But depreciation arising from careless use, or from abuse, and which is greater than that caused by ordinary and proper use, is a different matter, and ought to be paid for, or else the owner will get nothing for the injury to the property thus occasioned.

(*c*) The expenses incurred in returning the cars as the court ordered ought not to fall upon the owner, for it seems clear that the latter cannot be fairly charged with the cost of a delivery which it was manifestly the court's duty to effectuate.

(*d*) Interest should be allowed on all claims for the date on which the cars are returned to the lessor.[1]

§ 631. **Rentals due by the Mortgagor Company as Lessee of another Line. Rule.** — It will be shown in the succeeding chapter that a receiver is not bound to adopt a lease of a road entered into by the mortgagor. If he elects not to adopt such a lease, the claim of the lessor for rent which accrued prior to the receivership will not be accorded any preference as against the mortgage debt. A claim of this kind falls into the same category as those referred to in the last section.[2]

The same principle prevails with regard to the interest on the bonds of a lessor company which the lessee has agreed to pay as rent for the leased line, under a contract made prior to the mortgage under foreclosure, but not creating any lien on the property.[3]

§ 632. **Diversion of Earnings immaterial where Credit is given for Materials furnished.** — A supply creditor who has allowed the company a specified period of credit is precluded from obtaining a preference for his claim, even though the purchase-money was by the contract to be paid out of the earnings, and it is shown that some of the bonded interest was discharged out of the income accruing while the period of credit was running.[4]

§ 633. **Debts contracted for Original Construction not preferred.** — The cases holding that the priority of a mortgage debt may sometimes be displaced in favor of unsecured creditors, when those debts were contracted for keeping up a railroad, already built, as

[1] Lane, Receiver, *v.* Macon & Atl. Ry. Co. *et al.* (1895), 96 Ga. 630, 651; s. c. 24 S. E. Rep. 157.

[2] New York, P. & O. R. Co. *v.* New York, L. E. & W. R. Co. (1893), 58 Fed. Rep. 268, citing several cases as to rental of cars.

[3] Central Trust Co. *v.* Charlotte, C. & A. R. Co. (1895), 65 Fed. Rep. 264.

[4] Bound *v.* South Carolina Ry. Co. (C. C. A., 1893), 58 Fed. Rep. 473.

a going concern, have no application to a debt contracted for original construction.[1]

Hence a duly registered mortgage of a road "built and to be built," takes precedence, as regards the unbuilt portion, over the subsequent claim of a contractor who had himself finished it under an agreement with the company that he should retain its possession and apply its earnings to the liquidation of the debt due to him, and who had, in accordance with such agreement, taken possession of the road and retained it. "Registry of the mortgage," said the court, "was notice to all the world of the lien, and in that point of view the case does not even show a hardship on the contractor, as he must have known when he accepted the agreement that he took the road subject to the mortgage."[2]

Such a claim cannot be accorded priority on the ground that the contractor is the last creditor, and has aided in preserving the property. This doctrine has never been applied except in maritime cases, which stand on a particular reason.[3]

For the purposes of the rule it is immaterial that the work is done at the request of the lessee in possession of the property, and that there is a special contract that the person doing the work shall have a lien on the earnings.[4]

Of course the consent of the bondholders themselves may sometimes raise these debts to the preferred class, and the court will sometimes order a hearing to be had for the purpose of ascertaining their views.[5]

The principle that there is no equity in favor of the back claims of those who aid in constructing a road has been also assigned as a ground for denying priority to that part of a claim of counsel for fees which was based on services rendered before the road became a "going concern."[6]

[1] Toledo, D. & B. R. Co. *v.* Hamilton (1890), 134 U. S. 296; s. c. 43 Am. & Eng. R. R. Cas. 396; Fogg *v.* Blair (1890), 133 U. S. 534; Farmers' Loan & Trust Co. *v.* Pine Bluff, M. & N. O. R. Co. (Ark., 1893), 21 S. W. Rep. 652; Porter *v.* Pittsburg Bessemer Steel Co. (1887), 120 U. S. 649; s. c. 30 Am. & Eng. R. R. Cas. 472; Wood *v.* Guarantee Trust & Safe Deposit Co. (1888), 128 U. S. 416.

[2] Dunham *v.* Cincinnati, Peru, etc. R. Co. (1863), 1 Wall. 254.

[3] Galveston Railroad *v.* Cowdrey (1870), 11 Wall. 459, 481.

[4] Thompson *v.* White Water Valley R. Co. (1889), 132 U. S. 68; s. c. 40 Am. & Eng. R. R. Cas. 373; Meyer *v.* Johnston (1875), 53 Ala. 237.

[5] This was done in Farmers' Loan & Trust Co. *v.* Kansas City, W. & N. W. Ry. Co. (1892), 53 Fed. Rep. 182, and the necessary consent secured, it being apparent that the payment of the construction debts was for the interests of the secured creditors. Judge Caldwell at the same time took occasion to express his regret that any distinction was ever made as to these debts (see above).

[6] Finance Co. of Pennsylvania *v.* Charleston, C. & C. R. Co. (1892), 52 Fed. Rep. 526.

§ 634. **Damages for Breach of Contract not preferred.** — A claim for damages for breach of a contract to allow a mill-owner to haul lumber over a side track will not be accorded a preference either in regard to the income or the *corpus*.[1]

Nor has a claim for unpaid moneys due on a speculative contract any of the equitable features of a supply claim, and it does not acquire any higher priority merely from the fact that, in the order appointing the receiver, he was directed to carry out the contracts of the insolvent company. The same rule applies to a claim of damages by reason of the failure of the receiver fully to complete the contract.[2]

Where a railroad company enters into an agreement with a mining company, for instance, that if the latter will build a branch road leading to its mines and convey it to the railroad company, the latter will pay a fixed sum per ton for all coal shipped over the branch road to the mining company. Such a contract will create an equitable charge upon the earnings of the branch, and the receiver of the railroad in after-foreclosure proceedings will be required to give a preference over the mortgage bondholders to the mining company.[3]

§ 635. **Debts for Damages caused by Operation of Road.** — Debts for damages to property or persons caused by the operation are not, according to the great weight of authority, within the preferential class; at all events, their payment has been specially imposed as a condition of granting the appointment of a receiver. Thus it has been held improper, in the absence of such a provision, to allow a past-due claim for damages for the destruction of property by fire from a locomotive;[4] or for loss of goods in transit, whether by fire or otherwise;[5] or for personal injuries.[6]

1 Central Trust Co. *v.* Wabash, St. L. & Pac. Ry. Co. (1887), 32 Fed. Rep. 566.

2 Olyphant *v.* St. Louis Ore & Steel Co. (1866), 28 Fed. Rep. 729.

3 Fidelity Ins., Trust, & Safe Deposit Co. *et al.* *v.* Norfolk & Western R. Co. (Virginia & T. Coal & Iron Co., Intervener), (1896), 72 Fed. Rep. 704.

4 Hiles *v.* Case (1880), 9 Biss. 549; s. c. 14 Fed. Rep. 141. See also § 108, *ante*.

5 Easton *v.* Houston & Texas Central Ry. Co. (1889), 38 Fed. Rep. 12.

6 Central Trust Co. *v.* Wabash, St. L. & Pac. Ry. Co. (1886), 28 Fed. Rep. 871; Central Trust Co. *v.* East Tenn., Va. & Ga. R. Co. (1886), 30 Fed. Rep. 895; s. c. 30 Am. & Eng. R. R. Cas. 450; Farmers' Loan & Trust Co. *v.* Green Bay, W. & N. W. R. Co. (1891), 45 Fed. Rep. 664; s. c. 46 Am. & Eng. R. R. Cas. 296, denying the authority of Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 260; s. c. 17 Am. & Eng. R. R. Cas. 324, which countenances a different doctrine. See *ante*, for a caution as to the doubtful authority of this.

It is, however, worthy of notice that in the earlier case the question was as to the propriety of making the payment of the claim a condition of granting a receivership, while in the later case no such order had been made. The general reasoning of the later case, that the category

Where a railroad has been, in proceedings *quo warranto*, placed in the hands of a receiver by a State court, and the order afterwards vacated, with a restoration of the property to the company charged with a lien for damage suits during that receivership, and pending a suit for such a claim a mortgage given by the company is foreclosed in a federal court and a receiver appointed, notwithstanding the latter, being appointed a party, may appear in the suit in the State court and answer that without leave of the federal court such a claim, reduced to judgment in the State court, will not be recognized as having a priority of lien over the bondholders.[1]

Such claims are based upon the fact that they inure to the benefit of the security, or have been the means of keeping the road a going concern. A claim for damages for personal injuries against a company, within the six months prior to receivership, not being such a claim, will not be ordered paid from the income of the receivership.[2]

of claims which may be accorded priority over the mortgage, even against the consent of the mortgagee, and after the court has assumed control of the property, does not extend beyond those which are based upon things done for the benefit of the *res*, and consequently of the mortgagees, is undoubtedly sound. But it is, we think, fairly open to argument, whether a chancellor, when invited to exercise his discretion in appointing a receiver, may not, in view of all the circumstances of the case, require the payment of some other claims besides these. Claims for personal injuries, accruing while the road is in the hands of a receiver, are admitted to be entitled to payment as a part of the operating expenses. May there not be cases where it would be inequitable for the mortgagees to decline to pay such claims, merely for the reason that they accrued before the receivership was asked for, and may not the court mould its relief accordingly? The controversy really raises the broad question whether the limits of the class of debts known as preferential are identical, whether provisions for their payment is being made at the time the receiver is appointed, or after the receivership has begun. The cases show very clearly that as to most of these so-called "equitable liens" there is a complete identity. But no court of final resort, so far as we know, has pronounced for or against the doctrine that the domain of rights in each case is coextensive. The Supreme Court of the United States has expressly declared that the court which appoints the receiver has no right to demand that the mortgagees shall assent to the payment of *all* the claims of the general creditors (Kneeland *v.* American Loan & Trust Co. (1890), 136 U. S. 89; s. c. 43 Am. & Eng. R. R. Cas. 519); but a definite rule still remains to be formulated.

[1] Foreman *v.* Central Trust Co. of New York *et al.* (1896), 71 Fed. Rep. 776; s. c. 18 C. C. A. 321. The order of the State court, purporting to make this claim a lien superior to the mortgage, was further held not to be authorized by the Receivers' Act, Rev. St. Tex., arts. 1466 *et seq.* See Giles *v.* Stanton (1894), 86 Tex. 620; s. c. 26 S. W. Rep. 615; Fordyce *v.* Dubose (1894), 87 Tex. 78; s. c. 26 S. W. Rep. 1050, in which cases it was held that the rights of the bondholders, secured by a mortgage executed before the passage of the Receivers' Act, could not be affected or prejudiced by any lien which the court was authorized to impose under the provisions of that act.

[2] St. Louis Trust Co. *v.* Kelly (1895), 70 Fed. Rep. 32; s. c. 16 C. C. A. 110, followed in Ames *et al. v.* Union Pac.

The Supreme Court of Georgia has taken a position against the theories of all the decisions of the other courts on this subject, and held that a mortgagee having a right under his mortgage to possession of a railroad company and to control the income, where he prefers to foreclose his mortgage and to have a sale in his proceedings to that end, it is inequitable to give priority to the mortgage over a judgment for a tort against the railroad company obtained while the company was left in control of its property and income.[1]

In Tennessee, a statute expressly forbids the creation of a lien which shall be superior to claims for injuries to person or property caused by the operation of the road. A claim of this description does not forfeit the protection of the statute by being embodied in a formal contract; as where there is a compromise, by which the company binds itself to give an injured employee work for a specified period.[2]

This act of 1877, ch. 12, § 3, provides "that no railroad company or corporation shall have power under this act, or any of the laws of this State, to create a mortgage or other kind of lien on its property in this State, which shall be valid and binding against judgments or decrees, and execution therefrom, for timbers furnished

Ry. Co. *et al.* (1896), 74 Fed. Rep., 335; Farmers' Loan & Trust Co. *v.* Northern Pac. R. Co. *et al.* (Watts, Intervener), (1896), 74 Fed. Rep. 431.

In this last case Gilbert, C. J., said: "Such claims for injuries occurring under the receiver's own management are paid, it is true, in preference to the mortgage debt, not for the reason of their preferential nature, nor because of any superior equity in their favor over claims for damages which arose before the receiver was appointed, but because they are liabilities which were incurred by the receiver in the course of his own operation of the road, and are payable by him as other expenses of the management."

The court also distinguished Farmers' Loan & Trust Co. *v.* Northern Pac. R. Co. (1895), 71 Fed. Rep. 245. See as to judgments for personal injuries against a company not having a preference over bonds secured by a mortgage against earnings received before appointment of a receiver, voluntarily paid over to him by the company or from other moneys in his hands, Farmers' Loan & Trust Co. *v.* Detroit, B. C. & A. R. Co., *In re* Keating (1895), 71 Fed. Rep. 29.

In New York Security & Trust Co. *v.* Louisville, E. & St. L. R. Co. (1897), 79 Fed. Rep. 386, a judgment against the company for a death loss during the operation of the road was held not to be an operating expense which would entitle it to priority of payment over the mortgage; it was further held that the holder of the judgment could not, on the ground that a *supersedeas* bond given on an appeal by the company having caused him to lose his right to levy and sell the property, before it was placed in the hands of a receiver, he was equitably entitled to enforce the rights of the surety on the bond in behalf of his claim. See also Vlatch *v.* American Loan & Trust Co. (1897), 79 Fed. Rep. 471.

[1] Green *v.* Coast Line R. Co. *et al.* (1895), 97 Ga. 15; s. c. 24 S. E. Rep. 814 (1895), a well and thoroughly discussed case; opinion by Bleckley, C. J.

[2] Frazier *v.* East Tenn., Va. & Ga. R. Co. (1889), 88 Tenn. 138; s. c. 40 Am. & Eng. R. R. Cas. 358.

or work and labor done on its road, or for damage done to persons and property in the operation of its railroad in this State." In an intervention in a railroad foreclosure suit, a claim of a consignee of goods shipped for loss of the goods, growing out of their loss by fire as a result of non-delivery of the goods to intervener from carelessness or negligence of the company's agent, was recognized as a claim coming within the purview of this statute which gave it a lien upon the property prior and superior to the mortgage securing the bondholders.[1]

This Tennessee statute will not affect judgments obtained against a Tennessee railroad company whose road runs into another State; in the latter State, in actions or causes of action arising in that State, such judgments will not be given priority to the claims of the mortgage bondholders.[2]

That all contracts are made with reference to the law of the State in which the subject-matter of the contract is, and in which the contract is made, is true with regard to mortgages by a railroad corporation. The law enters into and becomes a part of the contract as if it were there in express terms.[3]

It follows that a person securing a judgment for personal injuries inflicted by negligence of a railroad company's employees, bringing his action within the time limited under the act of South Carolina (§ 1528, Gen. St. S. C. 1882), which makes this judgment relate back to the date when the cause of action arose, and be a lien as of that date, of equal force with the lien of employees for wages, and superior to the lien of any mortgage securing bonds, will be entitled to enforce its payment against one purchasing the property at foreclosure sale, subject to payment on his part of all liens superior to the mortgage.[4]

This ruling is in accord with that of the Supreme Court of the United States in a case brought by writ of error from the Supreme Court of Tennessee.[5]

A judgment against a railroad company for a tort, though the action be brought after the record of a mortgage upon its property, will be preferred in payment out of the earnings or property

[1] Central Trust Co. *v.* East Tenn., Va. & Ga. Ry. Co. (1895), 70 Fed. Rep. 764.

[2] Central Trust Co. of New York *v.* East Tenn., Va. & Ga. Ry. Co. (Simmons *et al.*, Interveners), (1895), 69 Fed. Rep. 658.

[3] Southern Ry. Co. *v.* BonKnight (1895), 70 Fed. Rep. 442.

[4] Southern Ry. Co. *v.* BonKnight (1895), 70 Fed. Rep. 442; s. c. 17 C. C. A. 181; followed in Central Trust Co. *v.* Madden (1895), 70 Fed. Rep. 451; s. c. 17 C. C. A. 31.

[5] East Tenn., Va. & Ga. R. Co. *v.* Frazier (1891), 139 U. S. 288; s. c. 11 Sup. Ct. Rep. 517, affirming 88 Tenn. 138; s. c. 12 S. W. Rep. 537 (1889).

in a foreclosure sale, under § 1255, Code of North Carolina, which provides that "mortgages of incorporate companies upon their property or earnings . . . shall not have power to exempt the property or earnings from executions for the satisfaction of any judgment obtained in courts of State . . . for torts . . .," etc.[1]

[1] Boston Safe Deposit & Trust Co. *v.* Hudson (1895), 68 Fed. Rep. 758 ; s. c. 15 C. C. A. 651 (1895).

Statutes of some of the States as to priority of liens to mortgage: Illinois, Rev. Stat. 1887, ch. 114, § 51, Liens upon railroads; Indiana, Rev. Stat. 1888, § 3919, Lien for taxes and debts; Kansas, Gen. Stat. 1889, § 1261, Judgment for damages prior in lien to mortgages executed thereafter. Kentucky, Rev. Stat. 1894, § 2487, Lien of employees and material-men superior to all other incumbrances; Mississippi, Code 1892, §§ 839, 3567, Mortgage of future earnings subordinate to debts contracted in carrying on the business of the corporation; Montana, Comp. Laws 1887, § 707, Judgment for injuries prior in lien to mortgage; Ohio, Rev. Stat. 1890, § 3398, Judgment for labor, supplies, or damages for injuries preferred to mortgage.

CHAPTER XXIX.

POSITION OF CREDITORS WHO MAKE EXPENDITURES EITHER CONTRIBUTING TO PRESERVATION OR ENURING TO BENEFIT OF MORTGAGED PROPERTY.

§ 636. **Mortgage Lien usually preferred to Claim of Lender to Company to pay Interest or Operating Expenses.**[1] — Debts due to persons who have lent money to pay interest or operating expenses are, as a rule, not entitled to preference as against the mortgage lien. Such a loan merely creates the relation of debtor and creditor between the mortgagor and the lender, and in the absence of some special consideration no equity can arise in favor of the latter as against other creditors holding a security prior in point of time, merely by reason of the voluntary application the debtor may make of the money borrowed.[2]

[1] As to rank of creditors paying coupons see also Chap. III.

[2] Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush, 673, 714; Morgan's La. & Tex. R. & St. Ship Co. *v.* Texas Central R. Co. (1891), 127 U. S. 171; s. c. 11 Sup. Ct. Rep. 61; 45 Am. & Eng. R. R. Cas. 631. In the latter case a railroad company which was interested in maintaining, as a going concern, a mortgaged connecting line, made large advances to the latter in consideration, as was alleged, of being reimbursed from the earnings. A large proportion of the loans was applied to the payment of the bonded interest, and the rest was used to defray operating expenses and pay taxes. Under these circumstances it was held that the lender was not entitled to any preference over the bondholders, either on the ground of a superior equity or by way of subrogation; and that even if the advances could have been treated as having been specifically applied to the payment of in-

On the other hand, it has been held that bondholders who, after receiving a promise from the officers of the road that they are to be reimbursed out of the net earnings, advance money to pay the wages of employees, and thus avert an impending strike, are entitled to be repaid this advance in preference to the rest of the bondholders out of the earnings coming into the hands of a receiver afterwards appointed.[1]

terest, which the evidence did not show to be the case, such payment would have afforded no basis for the assertion of a preference as against the bondholders. The fact that the interest coupons were, so far as disclosed, paid, not purchased, excluded the possibility of setting up any right based upon the hypothesis that they were still outstanding; and the contention was wholly inadmissible that the bondholders, because they received what was due to them, should be held to have assented to the running of the road at the risk of returning the money thus paid, if the company, by reason of unrealized expectations on the part of those who made the advances, should ultimately turn out to be insolvent. To charge the bondholders with the responsibility of the operation of a road, as against the party who, by supplying funds for the payment of interest, have prevented them from taking possession, was declared to be unreasonable. Nor was the claim of the lender strengthened by the fact that all that he did inured to the advantage of the public. "It is true," said Chief Justice Fuller, "that a railroad company is a corporation operating a public highway, but it does not follow that the discharge of its public duties excuses it from amenability to its private obligations. If it cannot keep up and maintain its road in suitable condition, and perform the public service for which it was endowed with its faculties and franchises, it must give way to those who can. To allow another corporation, which, for its own purposes, has kept a railroad in operation in the hands of the original company, by enabling it to prevent those who would otherwise be entitled to take it from doing so, a preference in reimbursement over the latter on the ground of superiority of equity, would be to permit the speculative action of third parties to defeat contract obligations, and to concede a power over the property of others, which even governmental sovereignty cannot exercise without limitation."

In Duncan *v.* Mobile & Ohio R. Co. (1876), 2 Woods, 542, decided before the doctrine as to "preferential debts" had been fully developed, Judge Woods came to the conclusion that he could not, without the assent of the bondholders, direct the application of the income of the road, after the *trustees* had taken possession, to the payment of a floating debt, part of which represented money spent in paying interest and making improvements. The mere fact that the payment appeared, under the circumstances, to be for the interests of the bondholders was declared not to furnish sufficient ground for such an exercise of judicial authority. The court has no right to make a contract for them because it thinks the contract a good one. In the same litigation the question was subsequently presented, whether a firm of bankers, who were also the financial agents of the company, and general managers of its pecuniary concerns, were precluded by their fiduciary position from repaying themselves from funds in their hands a loan which they had made for the purpose of enabling the company to pay interest on its bonds and other pressing obligations. Justice Bradley sustained the transaction, saying that it did not appear but that they had claims of the highest equity to be paid. See also Duncan *v.* Mobile & Ohio R. Co. (1877), 3 Woods, 567.

As pertinent to this note see *Re* Regent's Canal Iron Works Co., *Ex parte* Grissell, 3 Ch. Div. 411; *Re* Ormerod, Grierson, & Co. (1890), W. N. 217.

[1] Atkins *v.* Petersburg R. Co. (1879), 3 Hughes, 307; s. c. 2 Fed. Cas. 90, Case No. 604. There the order was made after

This rule has been declared by the Court of Appeals of New York in a late case. The right of a creditor of an insolvent corporation in the hands of a receiver to have a preference over bondholders under a first mortgage is *strictissimi juris*. . . . A party loaning money to an embarrassed corporation subsequently adjudged to be insolvent, and taking security therefor, is not in a position which entitles him in equity to be adjudged to have a lien on mortgaged property of the corporation or its proceeds in preference to bondholders under a mortgage existing when the loan was made, and it is immaterial for what purpose the loan was made, or how the money received thereon was applied, provided the bondholders were not parties to the transaction.[1]

A recognized method by which one who desires to assist a company to pay debts, which are entitled to some special preference by way of lien or otherwise, may protect himself, is to purchase those claims himself, and thus secure all the rights to which the claimants may be entitled.

Further illustrations of the principle upon which the above cases turned will be found in Chapters II., III., on the questions whether bonds and coupons are to be treated as bought or paid.

§ 637. **Lender, how far entitled to the Benefit of a Statutory Lien held by the Creditor paid.** — The general rule stated in the last section is in no way qualified by the mere fact that the cred-

the appointment of a receiver, the court holding that the case fell within the doctrine of Fosdick *v.* Schall, that preferred claims may be thus provided for, even if their payment has not been made a condition of the appointment. Fosdick *v.* Schall is not an authority for the broad doctrine here attributed to it. (See Chap. XXVII.) But that doctrine is undoubtedly within the spirit of Miltenberger *v.* Logansport Ry. Co. (*supra*), and is strongly supported by the analogy of the cases in which the surety on an injunction bond has been granted the privileges of a preferred creditor. (See § 642, *post.*)

[1] Farmers' Loan & Trust Co., Trustee, *v.* Bankers' & Merchants' Telegraph Co. *et al.*, In the matter of the claim of the Third National Bank of the City of New York (1896), 148 N. Y. 315; s. c. 42 N. E. Rep. 707. The bank sought to have its claim for money loaned the company placed on a footing with claims of persons who had in the foreclosure proceedings received receiver's certificates, with a priority of lien by order of the court, further claims based upon the equity of the same. With reference to this contention Chief Justice Andrews said: "There is a sound equity which supports the doctrine that when the nature of the property is such that the business to which it has been devoted cannot be discontinued without great probable loss, the court may authorize it to be continued by its officer and receiver, pending the closing up of the affairs of the insolvent corporation. Expenses incurred by a receiver under such circumstances may be justly said to be expenses of preservation for the benefit of bondholders or other persons entitled to share in the final distribution, which ought to be first paid. But it is obvious that with the best intentions attempts by the court to carry on the business of a railroad or of a telegraph company through its receiver are hazardous, and we think courts may well pause before extending the application of the principle to which we have adverted."

itors who are paid with the money advanced had a statutory lien upon the property of the corporation.[1]

A construction more favorable to the person advancing money to pay off debts of a preferred class has, however, been placed upon the Mississippi Code (pars. 839 & 3567), which provides that no mortgage of the income, future earnings, or rolling-stock of a railroad corporation shall be valid against debts contracted in carrying on the business of the corporation. Under this provision persons making advances to enable the company to pay off taxes, balances due to other lines, and arrears of wages are entitled to payment, as against the mortgagees, out of the income, whether earned before or since the appointment of the receiver, if that suffices, and, if there has been a diversion of the income, out of the proceeds of the sale of the railway.[2]

§ 638. **Rule when the Person advancing the Money is a Court Official.** — It has been shown in an earlier chapter that a receiver cannot of his own motion issue certificates which shall be a first lien on the trust estate. As a consequence of this doctrine, it has been held that a receiver who has paid interest on the bonds of a subordinate company will not be reimbursed by receiver's certificates constituting a lien on the property of the latter company prior to the mortgage securing the bonds, but that his claim will be admitted, ranking next after the mortgage.[3]

In England a more severe doctrine has been laid down in regard to the administration of an insolvent canal company in winding-up proceedings. Advances made by a liquidator, even when made under the sanction of an order of court, will not be given priority of payment out of the *corpus* of the estate as against the claims of mortgagees, even though the transaction was for the benefit of the debenture-holders; and a sale of the property at the time the advances were made would probably have produced a much smaller amount than was ultimately received, in consequence of the fact that the advances were so made, and the necessity for a sale postponed. The debenture-holders have a right to express their opinion whether the business shall be carried on at their risk, and cannot be bound by any such arrangement unless they are brought before the court, and assent thereto.[4]

[1] Suddath *v.* Gallagher (1895), 126 Mo. 393.

[2] Farmers' Loan & Trust Co. *v.* Vicksburg & Meridian R. Co. (1888), 33 Fed. Rep. 778.

[3] Phinizy *v.* Augusta & K. R. Co. (1894), 62 Fed. Rep. 771.

[4] *In re* Regent's Canal Works (1875), L. R. 3 Ch.Div. 411. The reason here assigned illustrates the distinction taken in this country between the powers of a court in managing the affairs of a private and a *quasi* public corporation. See Chap. XXIX.

The fact that the lender takes collateral security for his loan is regarded as almost conclusive evidence that he relied on the credit of the company and the security so furnished.[1]

Thus where the company receives a loan from a bank of $40,000, giving therefor an indorsed note, and at the same time deposits with the lender, as collateral, $80,000 of the bonds secured by the mortgage under foreclosure, the presumption is that the lender relied for its ultimate security on the indorsers of the note and the proceeds of the bonds.[2]

But it seems that, in such a case, if the money is lent for the express purpose of paying the bonded interest, and was so applied, the loan should be regarded as a preferential debt, at least if it is made with the knowledge and consent of the trustees.[3]

The same result would doubtless follow if the trustees are shown to have been guilty of any fraud or deception in concealing the insolvency of the company, and thus inducing the lender to make the advance.[4]

§ 639. **Lender of Money to pay for Rolling-stock, when not entitled to a Preference on the Ground of Subrogation to Vendor's Lien.** — Aside from the cases in which subrogation is allowed in cases of sureties and other persons who satisfy claims against third parties to protect their own rights, subrogation can only result from an express agreement either with the debtor or creditor, and therefore cannot be predicated of a case where there is a mere understanding on the part of persons advancing money to pay the instalments of the price of rolling-stock, subject to a vendor's lien till fully paid for, that they shall be subrogated to that lien, and there is nothing to show that they occupy the position of guarantors on the contract, or are in any way bound for its per-

[1] Addison *v.* Lewis (1882), 75 Va. 701; s. c. 9 Am. & Eng. R. R. Cas. 702; Fidelity Insurance, Trust, & Safe Deposit Co. *v.* Shenandoah Valley R. Co. (1889), 86 Va. 1; s. c. 9 S. E. Rep. 751; 38 Am. & Eng. R. R. Cas. 559. In the latter case the claimants, a firm of bankers who acted as financial agents of a railroad company, also contended that, as they had surrendered coupons of the first and second mortgages, and received in exchange bonds secured by an income or third mortgage for sixty per cent. of their par value, such bonds being guarantied to a certain extent by a third and solvent party, and issued to pay the floating and accruing indebtedness of the company, they were entitled to the benefit of the lien of the prior mortgages; but the court held, upon a review of the circumstances, that the transaction amounted to a satisfaction of the coupons surrendered.

[2] Penn *v.* Calhoun (1887), 121 U. S. 251; s. c. 7 Sup. Ct. Rep. 906.

[3] Penn *v.* Calhoun (1887), 121 U. S. 251; s. c. 9 Sup. Ct. Rep. 906. In that case, however, the evidence failed to satisfy the court that any part of the money lent had been used directly in the payment of the interest.

[4] This ground was also relied on in Penn *v.* Calhoun, *supra*, but was not established by the evidence.

formance. Even supposing such a loan to have been made by the directors of the company, and that, as trustees, they are entitled to an equitable lien on the trust property on the ground that the money was advanced for the protection and preservation of the property committed to their care, it is premature to attempt the enforcement of such a lien until all the instalments of the purchase price have been paid. Whatever rights the lender may have in such a case are necessarily subordinate to those of the owners of the rolling-stock, and until a creditor is wholly satisfied, there can be no interference with his rights or his securities, which may, even by bare possibility, prejudice or embarrass him in any way in the collection of the residue of his claim. For this reason a petition will be denied by which persons thus advancing money seek, immediately after the institution of a foreclosure suit and the appointment of a receiver, and while several instalments of the price of the rolling-stock remain unpaid, to obtain an order directing the receivers, if they decide to retain possession of the rolling-stock, to pay to the petitioners the amount of their advances out of the first money that comes in their hands. Such an order might greatly prejudice the vendors in the enforcement of their right to the control of the property which constitutes their only security, and, in effect, would actually place the petitioners in a better position than the vendors, by giving them a prior right to the only fund out of which payment can be made to either party. The presentation of such a petition at such a time is also premature, for the reason that it amounts to an attempt at an early stage of a foreclosure suit to establish, in an irregular manner, the priority of a lien. All those who claim liens antagonistic to the lien thus set up have a right to be heard, and the consideration of the subject-matter of such a petition must therefore be postponed until the court, upon the hearing of the cause, at some other proper time, proceeds to settle the respective rights and priorities of all parties claiming liens upon the mortgaged premises.[1]

§ 640. **Preference for Lender's Claim asserted on the Ground of Estoppel.** — Before any legal proceedings are instituted to enforce the mortgage, the bondholders may undoubtedly exercise such control over the property, and may so request and sanction the act of a third party in advancing money for the benefit of the property, as to estop them from setting up their mortgage as a lien paramount to the claim of one who has thus acted on the

[1] Receivers of New Jersey Midland Ry. Co. *v.* Wortendyke (1876), 27 N. J. Eq. 658.

faith of their request or direction. But the mere fact that the bondholders have authorized a loan to be made for construction purposes does not of itself give one who subsequently pays the debt for the accommodation of the company an equity superior to the mortgage. To obtain such an equity, he must show that he acted under such inducements from the bondholders, and had such dealings with them in the transaction, as to be entitled to claim against them the benefit of an estoppel *in pais*.[1]

§ 641. **What Protection is accorded and Preferences given to Sureties on Bonds given by the Company during Litigation.** — (a) *Appeal Bonds, Sureties on.* — If a debt established against the company by the judgment of a trial court is not itself of such a character as to be entitled to priority over the mortgage, the surety on an appeal bond does not, by paying the judgment, after it has been affirmed by the appellate court, acquire any equitable claim to be reimbursed out of the funds in the hands of a receiver appointed while the appeal was pending in preference to the bondholders.[2]

That the surety in such a case is the attorney of the company does not change this rule.[3]

The fact that the assets of the company are preserved and increased by the satisfaction of such a judgment is immaterial, for, whatever the amount or character of those assets, the mortgagees are still entitled to be paid therefrom in preference to creditors holding claims of a subordinate rank.[4]

One who, while a railroad company is apparently solvent, and not in default as to interest on its bonds, becomes surety on an appeal bond in an action on covenants made by the company, will not be considered, by his act in becoming surety, to have kept the company a going concern to the benefit of the bond-

[1] Kelly *v.* Green Bay & Minnesota R. Co. (1881), 10 Biss. 151. It may be noticed that the distinction between debts for operating expenses and for construction was not adverted to in this case. The court rendered its decision solely upon the ground that, unless an estoppel was shown, the petitioner's claim had accrued too long before the receivership to be enforced under the "six months' rule."

[2] Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. 24 Fed. Rep. 98. In Bayliss *v.* Lafayette, M. & B. R. Co. (1879), 9 Biss. 90; s. c. 2 Fed. Cas. 1080, Case No. 1141; 8 Rep. 579, the court allowed the surety in a similar case to be reimbursed out of the funds in the hands of the receiver, merely remarking that, "whenever a party in legal proceedings has become security for a railroad, in good faith, he ought to be protected." The distinction taken in the text was not noticed, but the demand for which judgment was given was, as a matter of fact, a lien demand.

[3] Blair *v.* St. Louis, H. & K. R. Co. (1885), 23 Fed. Rep. 523.

[4] Farmers' Loan & Trust Co. *v.* Northern Pac. R. Co. (1895), 68 Fed. Rep. 36, distinguishing Union Trust Co. *v.* Morrison, *infra*.

holders; and, in case of foreclosure of mortgages afterwards, though he may have had to pay the bond, will have no preference over the mortgagees against the *corpus* of the property.[1]

Since the rights of the owner of land used for a railroad are paramount to the lien of the mortgagees under an after-acquired property clause, sureties on a bond given in an appeal from a judgment rendered against the company in condemnation proceedings are entitled, after being forced to pay the judgment, to be reimbursed from the proceeds of sale in the hands of a receiver appointed to take charge of the railroad after the appeal was taken.[2]

(b) *A Surety on an Injunction Bond* given to protect the rolling-stock and property of the company from execution and sale is entitled to be protected and indemnified by a receiver appointed while an appeal from a decree dissolving the injunction is still pending. If, therefore, he pays a judgment against him on his bond, he is entitled to be reimbursed out of the property and assets of the company in preference to the mortgagees. To establish his right it is not necessary that the surety should show that there has been a diversion of earnings. Such a claim does not stand on the same footing as a debt for labor supplies and the like. It is based on a *bona fide* effort made to preserve the fund itself from waste and spoliation after the mortgage was in arrear, and the right to reduce it to possession had accrued.[3]

Where property of a railroad company absolutely essential to the operation of its road is levied upon by attachment, and the trustee of a mortgage securing bondholders requests a third party to go upon the replevin bonds in order that the property may be retained for the service of the company, and the surety on the bond afterwards, upon a judgment in favor of the attaching creditors, becomes liable on the bond and cannot restore the property,

[1] Whiteley *v.* Central Trust Co. of New York (1896), 76 Fed. Rep. 74.

[2] Rome & D. R. Co. *v.* Sibert (1892), 97 Ala. 393; s. c. 12 So. Rep. 69.

[3] Union Trust Co. *v.* Morrison (1887), 125 U. S. 591, distinguishing Burnham *v.* Bowen (1884), 111 U. S. 776; s. c. 17 Am. & Eng. R. R. Cas. 308.

In Farmers' Loan & Trust Co. *v.* Northern Pac. R. Co. (1895), 71 Fed. Rep. 245, sureties on an appeal of the railroad company from a judgment against it, by whose action of executing the bond the funds of the company had been protected from abstraction by garnishment proceedings, were held, in a foreclosure proceeding to enforce a mortgage for bondholders begun pending the appeal, to be entitled to have their claim deemed a current operating expense accruing during receivership and paid out of current earnings. See, as supporting this rule, Farmers' Loan & Trust Co. *v.* Kansas City, W. & N. W. Ry. Co. (1892), and the exhaustive note of M. M. Cohen, Esq., appended to this case, 53 Fed. Rep. 182–196; and Trust Co. *v.* Morrison (1887), 125 U. S. 591–613; s. c. 8 Sup. Ct. 1004.

if the trustee has instituted proceedings for the benefit of the bondholders, and receivers have been appointed, the court may properly direct the payment of the attaching creditor's claims out of the proceeds of the sale of the *corpus* in preference to the mortgagees.[1]

§ 642. **Status of Persons paying Taxes on the Mortgaged Property.** — A bondholder has a sufficiently direct interest in the preservation of the trust property to be entitled to be subrogated to the lien of the State for such taxes as he may pay in order to prevent the sale of the property.[2]

Such a case obviously comes within the well-recognized principle that the person advancing money to pay a debt is substituted to the place of the creditor, without any express agreement to that effect, when the payment is made to protect the rights of the lender.[3]

On the other hand, where a reorganized company purchases and receives possession of the road, and thereafter, with the authority of the court, pays certain taxes which would have been a lien on the road, and also the running expenses of the road during the receivership, the inference is that the payments were made to clear the title to the property, and the reorganized company will not be entitled to be reimbursed out of the proceeds of the sale.[4]

[1] Jones *v.* Central Trust Co. of New York *et al.* (1896), 73 Fed. Rep. 568. Severens, D. J., said: "From what has been stated, it is obvious that this liability of the sureties was incurred for the purpose of preserving the fund which will ultimately be appropriated to the payment of the mortgage debt. It is not the case of an equity arising, as in many cases has happened, from the diversion of current income from the payment of ordinary current operating expenses to the payment of the mortgage; but it is the case of an equity arising from the saving in a case of necessity of the mortgaged property itself, and that upon the call of the trustee by persons who exposed themselves to liability solely for the accommodation and benefit of the beneficiaries under the mortgage, — the sureties having, so far as appears, no interest of their own to protect." The court commented at length on Trust Co. *v.* Morrison (1887), 125 U. S. 591; s. c. 8 Sup. Ct. Rep. 1004, as authority for the ruling.

[2] Humphreys *v.* Allen (1881), 100 Ill. 511.

[3] Sandford *v.* McLean (1832), 3 Paige Ch. (N. Y.) 117.

[4] Central Trust Co. *v.* Cincinnati, J. & M. Ry. Co. (1893), 58 Fed. 500.

CHAPTER XXX.

POWERS OF A COURT AND ITS RECEIVER IN MANAGEMENT OF RAILWAY.

Article I. — In General.

§ 643. **Power of appointing Court plenary in Regard to the Management of the Estate.** — When a mortgagee in an action to foreclose his mortgage invokes the extraordinary aid of a court of equity by the appointment of a receiver of the mortgaged property in his interest, he thereby submits to the reasonable discretion of the court in the management and control of the property through its receiver, and the action of the court in that respect represents and binds the mortgagee as well as the owner. Upon the principle of this rule, a contract by which a receiver in foreclosure proceedings against a railroad company permitted another com-

pany to have perpetual joint use of a portion of the route of the defendant company, under order of the court, was held to be a binding one, and the court denied the motion of a purchaser at foreclosure sale to vacate the order or to limit the duration of the agreement or lease to the time the purchaser went into possession.[1]

A court of general equity jurisdiction has full power, in dealing with the estate of an insolvent corporation which has passed into the hands of a receiver, to direct the manner in which the corporate property shall be managed while in the receiver's possession, and the conditions on which the funds shall be paid out.[2]

If, in the course of the receivership, the court makes an order which the parties to the suit consider injurious to their interest, it is their duty to file a motion at once, asking the court to cancel or modify it.[3]

Where a receiver appointed by a State court has money in his hands when the cause is removed to a federal court, the latter court has full authority to make him account for the funds.[4]

After a receivership is terminated by a compromise, carried into effect by a consent decree which defines the future relations of the various parties in interest, the position of the court ceases to be one of prerogative and control, and becomes practically one of subordination to the agreement of the parties, its functions being merely the giving of formal assent and sanction to the arrangements devised by the contracting parties.[5]

§ 644. **Nature and Extent of Powers exercised by Receiver, by what determined.** — The nature and extent of the powers, whether ordinary or special, which a court will undertake to exercise through a receiver, in administering an insolvent railroad, are determined by the fact that the office is created to serve a temporary purpose. "The management (of a receiver) is an *interim* management; its necessity and justification spring out of the jurisdiction to liquidate and sell; the business or undertaking is

[1] Farmers' Loan & Trust Co. *v.* Staten Island Belt Line R. Co. (1896), 17 Misc. Rep. 107; s. c. 39 N. Y. Suppl. 872, affirmed in Same *v.* Same, 6 App. Div. 148; s. c. 39 N. Y. Suppl. 996 (1896).

[2] Woodruff *v.* Erie Ry. Co. (1883), 93 N. Y. 609; s. c. 16 Am. & Eng. R. R. Cas. 501.

[3] United States Trust Co. *v.* Wabash Western Ry. Co. (1892), 150 U. S. 287; s. c. 14 Sup. Ct. Rep. 86. The rule in the text was here applied to a case in which the court had ordered the receiver to pay rentals only after the discharge of preferential debts.

[4] Hinckley *v.* Railroad Company (1879), 100 U. S. 156.

[5] Vermont & Canada R. Co. *v.* Vermont Central R. Co. (1877), 50 Vt. 500.

managed and continued in order that it may be sold as a going concern, and with the sale the management ends."[1]

It has indeed been laid down in one case that a court of equity having in charge the mortgaged property of a railroad company is authorized to do all acts not beyond the powers of the company itself that may be necessary to preserve the property, and to give it additional value, not only for the benefit of the lien-creditors, but also for the benefit of the company, whose possession the court has displaced.[2]

But this sweeping language needs much qualification, if it is intended to serve as a statement of the powers which a court may, of its own motion and without regard to the wishes of the lienors and other creditors, undertake to exercise in the administration of the estate, or even as a statement of what the court may do with the consent of the various parties in interest. A more correct view of the powers which a court may legitimately exercise through a receiver, is that it may authorize its officers to do every thing that may be necessary to keep the property intact, and free from loss or injury.[3]

A court is in any case averse to making any radical changes in the condition of the road, and its unwillingness to do so increases in proportion as the time for the transfer of the property to the new owners draws nearer. Probably a court cannot, without the consent of the secured creditors, use even the earnings in building extensions.[4]

And it is certain that no such work can be undertaken so as to prejudice the rights of those creditors in regard to the *corpus* of the property lien.[5]

[1] Gardner *v.* London, etc. R. Co., L. R. (1866), 2 Ch. App. 201, per Cairns, L J. For a general review of the limits of the powers which a court may rightfully assume in contracting debts for the conservation of the property during a receivership, see an article by the late Mr. Albert Gallup in 4 Law Quarterly Review (Engl.), 300. This article relates entirely to the practice of the American courts.

[2] Gibert *v.* Washington City, Va. Midl. & Grt. Southern R. Co. (1880), 33 Gratt. (Va.), 586 ; s. c. 1 Am. & Eng. R. R. Cas. 473.

[3] Wabash, St. L. & Pac. R. Co. *v.* Central Trust Co. (1884), 22 Fed. Rep. 269, 271.

[4] In Gibert *v.* Washington City, Va. Midl. & Grt. Southern R. Co. (1880), 33 Gratt. (Va.) 586 ; s. c. 1 Am. & Eng. R. R. Cas. 473, the court, while declining to pass upon the abstract question of the power of the court to authorize the receiver to contribute from the trust fund towards the building of a short branch road, held that, as the expenditure had turned out to be eminently advantageous for all the parties in interest, and no objection to the action of the court had been raised for two years, an assignment of error based upon the theory that such action was an excess of the court's powers must be overruled.

[5] In Cowdrey *v.* Railroad Co. (1870), 1 Woods, 331, the court refused, after the principal cause had been taken up on ap-

§ 645. **Receivers have only such Powers as are conferred on them by the Court appointing them.** — The receiver is but the creature of the court, and has no powers except such as are conferred on him by the order of his appointment and the course and practice of the court.[1]

There is no authority for the theory that, apart from statute, a receiver may, in virtue of his office, make a contract without the authority of the court, which will bind the trust, or which the court will be bound to recognize without regard to its necessity or propriety. He may, it is true, appropriate moneys in his hands belonging to the trusts to such purposes connected with the trust as he may think proper, always taking the risk that the court will finally approve his action; but until his contracts are approved the court is at liberty to deal with them as it may deem to be just, and may either modify them or disregard them entirely.[2]

peal, to authorize the receiver to purchase a bridge, or to build or contract to use a loop line for the purpose of making connections with another road.

[1] Booth *v.* Clark (1854), 17 How. 322, citing Verplanck *v.* Mercantile Ins. Co. (1831), 2 Paige Ch. 438, 452; Davis *v.* Gray (1872), 16 Wall. 203. In Ellis *v.* Boston, Hartford, & Erie R. Co. (1871), 107 Mass. 1, is given a *résumé* of a comprehensive order of appointment of a railroad receiver. For another example of such an order, see Bank of Montreal *v.* Chicago, C. & W. R. Co. (1878), 48 Iowa, 518. In Central Trust Co. *v.* Wabash, St. L. & Pac. Ry. Co. (1885), 23 Fed. Rep. 863, will be found set out the proper orders to be entered concerning the operation and management by receivers of a system of roads extending through several States, made up of various consolidated and leased lines. See also, as to payments to be made by a receiver, the order quoted in Fosdick *v.* Schall (1879), 99 U. S. 235.

[2] Lehigh Coal & Navigation Co. *v.* Central R. Co. of New Jersey (1882), 35 N. J. Eq. 426; s. c. 9 Am. & Eng. R. R. Cas. 479, per Van Fleet, V. C., who pointed out that the passage quoted below, from Mr. Justice Bradley's opinion in Cowdrey *v.* Railroad Co., simply prescribes what expenditures, out of the funds in his hands as receiver, the court will recognize as legitimate and proper, when the receiver comes to account for the administrations of his trust. In a later New Jersey case it was held that the statute of that State which provides that, if the property of an insolvent railroad company passes into the hands of a receiver under the order of a chancellor, "the receiver shall operate the railroad for the use of the public, subject to the order of the chancellor," enlarged the powers of a receiver by constituting him in effect a statutory agent, authorized to do with the railroad what he thinks proper for the public interest, unless restrained by the express order of the chancellor, — the result being that he possesses as an incident of the duties imposed upon him an implied power to make all such contracts for labor and supplies as are reasonably necessary to enable him to perform the duties of his office, and that his contracts for such purposes bind the trust. Lehigh Coal & Navigation Co. *v.* Central R. Co. of New Jersey (1886), 41 N. J. Eq. 167. But this view was rejected by the Court of Errors and Appeals (s. c. (N. J. Eq., 1888) 35 Am. & Eng. R. R. Cas. 18), where the conclusion of the majority of the judges was that there was "nothing in this legislation giving the contracts of a receiver in running a railroad any greater force than contracts made by a receiver for the preservation of the property of any insolvent railroad." At the same time it was held that there was nothing in the enactment to countenance the notion that

A receiver of a corporation appointed and ordered to operate and manage the property pending the action in which he is appointed is not bound to carry out an executory contract made by the corporation prior to his appointment, and may in his discretion refuse to do so. Nor is his action in such case affected by the act of Congress (24 U. S. Stats. at Large, 554, §§ 2, 3).[1]

Where plans for work to be done upon a building, say upon land belonging to a railroad company, not covered by a mortgage executed by the company in process of foreclosure under a contract with the receiver, are submitted to the court and approved,

a receiver's contract might be revoked or annulled at the pleasure of the chancellor. Theoretically the chancellor had the power to retain in his hands the administration of the trust, and personally to direct and order each contract into which the receiver should enter; but, in the nature of the case, it must have been contemplated by the legislature that, in the performance of the multifarious duties involved in the operation of the road, some degree of discretion might be accorded to the receiver. This legislation, therefore, seems virtually to be considered as merely a declaration that the discretionary powers of a receiver, appointed in pursuance of it, are to be what they are under the ordinary rules observed by courts of equity in administering upon insolvent estates of other kinds.

For a case in which the extent of the powers of receivers appointed by special legislative provision to take charge of a railroad to enforce a lien in favor of the State, see State of Tennessee *v.* Edgefield & Kentucky R. Co. (1880), 6 Lea (Tenn.), 353; s. c. 4 Am. & Eng. R. R. Cas. 87. There the statutory receivers were held to be in a manner public agents, who did not bind the State unless they acted within the scope of their powers. They had no authority, it was said, to contract debts to be paid otherwise than out of the earnings of the road. Nor could they lease the road. Any lease made by them, not previously authorized or subsequently ratified by the State, was absolutely void, and not susceptible of being validated by the fact that the receivers had accepted rents from the lessee. The lessee consequently could not recover for improvements made on the road under such a lease. The powers of these receivers was again considered in Lafayette Co. *v.* Neely (1884), 21 Fed. Rep. 738. After one of the roads under the charge of one of them had passed into the hands of a purchaser, a stockholder filed a bill for an accounting, and questioned, among other things, the propriety of his expending some of the earnings on betterments. The court was of opinion, upon general principles, that his outlay upon permanent improvements, and on such articles as rails, which had been delivered, but had not been fully paid for when the receivership began, could not be complained of. Besides this, he was by law invested with plenary powers in the matter of managing the road; and as the improvement of the road was certainly conducive to the interests of the State, which were paramount to those of the stockholders, he was clearly entitled to expend the earnings in bringing the road into such a condition that it was fit to be used as one of the links in the great transportation system of which it formed a part.

[1] Scott *et al.* *v* Rainier Power & Railway Co. *et al.* (1895), 13 Wash. 108; s. c. 42 Pac. Rep. 531.

That a receiver of a corporation is not bound to carry out its executory contracts except as he elects, see Central Trust Co. *v.* East Tennessee Land Co. (1897), 79 Fed. Rep. 19.

As to the remedy of a lessor in such a case against a receiver, to compel an election, see Thomas *v.* Cincinnati, N. O. & J. P. Ry. Co. (1896), 77 Fed. Rep. 667. See also Spencer *v.* Brooks (Ga., 1896), 25 S. E. Rep. 480.

this will dispense with the necessity of a prior order of the court to the receiver to contract for such work, and the fact that there was no prior order entered will not invalidate the contract.[1]

It is not absolutely necessary where there are receivers of corporate property that the contracts made with third parties for the benefit of the property be executed by all the receivers to bind the trust property.[2]

A receiver has no power to contract for legal services so as to bind the fund in his hands, or the property, except by order of the court appointing him.[3]

Any acts of a receiver not within the scope of the authority conferred by the order appointing him, and not otherwise authorized by the court, do not bind the court.[4]

"Under ordinary circumstances, the submission by the receiver of his accounts to the master at frequent intervals, so that the latter may ascertain from time to time the character of the expenditures made, and disallow whatever may not meet his approval, will be regarded as a sufficient reference to the court for its ratification of the receiver's proceedings. But, in extraordinary cases, involving a large outlay of money, the receiver should always apply to the court in advance, and obtain its authority for the purchase or improvement proposed." [5]

Loans of a large amount, if effected without obtaining the authority of the court, will not be allowed a priority as against the bonds, even though the money is applied to the payment of expenses, which the court may authorize to be met by creating a first lien on the property.[6]

Nor, as a general principle, has a receiver any power to bind the trust by contracts which involve large outlays, and which may extend beyond the life of the receivership.[7]

A person managing and controlling a road, as its receiver, will not be assumed to have exceeded his authority in making

[1] Girard Insurance & Trust Co. *v.* Cooper (1896), 162 U. S. 529; s. c. 16 Sup. Ct. Rep. 879.

[2] Ibid.

[3] International & Great Northern R. Co. *v.* Herndon (Tex. Civ. App., 1895), 33 S. W. Rep. 377. See also International & Great Northern R. Co. *v.* Wentworth (1894), 8 Tex. Civ. App. 5.

As to employment of counsel by receiver, see Farwell *v.* Great Western Tel. Co. (1896), 44 N. E. Rep. 891.

[4] Farmers' Loan & Trust Co. *v.* Chicago & A. Ry. Co. (1889), 42 Fed. Rep. 6; s. c. 8 Ry. & Corp. L. J. 184.

[5] Cowdrey *v.* Railroad Co. (1870), 1 Woods, 331, per Bradley, J.

[6] Union Trust Co. *v.* Illinois Midland Ry. Co. (1887), 117 U. S. 434; s. c. 25 Am. & Eng. R. R. Cas. 560.

[7] Chicago Deposit Vault Co. *v.* McNulta (1894), 153 U. S. 554.

a contract of rebatement. Such excess of authority must be affirmatively shown.[1]

§ 646. **Principles upon which Contract Claims against Receivers will be allowed or rejected by the Court.** — The first question to be determined in every case in which a claim based upon contract is presented against a road in the hands of a receiver is whether it is of a character to entitle the applicant to the relief asked for. If the contract has been completely performed, and its performance accepted by the receiver, and the claim is merely for compensation, relief of that kind would seem to be proper in all cases, unless where the applicant has dealt fraudulently or collusively with the receiver, to the detriment of the trust. Even if, in the judgment of the court, the contract was injudicious, or improvident, and unreasonable, no just reason can be given for debarring the contractor from the stipulated compensation, unless he had notice of the improper character of the contract; for the receiver may be required, as a penalty for his misconduct or negligence, to reimburse to the trust fund any payment on account of such a contract.

But if the contract has not been performed, the court will proceed on the principle that every one who contracts with the receiver must be assumed to know that, if he seeks to enforce his contract, it must come under the scrutiny of a court of equity; and that, if it there appears to be injurious to the trust, the court will not carry it out. He cannot complain, therefore, if the court

1 Bayles *v.* Kansas Pacific R. Co. (1889), 13 Colo. 181; s. c. 22 Pac. Rep. 341; 6 Ry. & Corp. L. J. 448; 40 Am. & Eng. Corp. Cas. 42.

Order of court as to wages of employees of a company under its control, when not violated by receiver. Dexter *v.* Union Pac. Ry. Co. (1896), 75 Fed. Rep. 947.

As to a court's right to continue a receiver of a street railway in the possession of the streets of a city. Louisville Trust Co. *v.* Cincinnati Inclined Plane Ry. Co. (1897), 78 Fed. Rep. 307.

As to powers of receiver appointed at instance of debenture-holders and liquidator in winding-up proceedings under English rules and statutes, see Campbell *v.* Compagnie Generale de Bellegarde, 2 Ch. Div. 181; Bartlett *v.* Northumberland Avenue Hotel Co. (1885), 35 L. T. Rep. 611; Strong *v.* Carlyle Press (1893), 1 Ch. (C. A.) 268. Liquidator acting as receiver: *Re* Joshua Stubbs (1891), 1 Ch. (C. A.) 475, 482; British Linen Co. *v.* South American & Mexican Co., 37 Sol. J. 840; Willmott *v.* London Celluloid Co. (1885), 34 Ch. Div. 147; Perry *v.* Oriental Hotels Co., 5 Ch. App. 420; Tottenham *v.* Swansea Zinc Ore Co., 32 Wkly. Rep. 716. Powers as to books: General Assets Purchase Co. *v.* Chesterton Coal Co. (1888), 32 Sol. J. 645; *Re* Clyne Tin Plate Co., 47 L.T. Rep. 439; Engel *v.* South Metropolitan Brewing Co. (1892), 1 Ch. 442.

As to the discretion of the court in such appointments, see Stanford Banking Co. *v.* Allchin (1891), 26 L. J. N. S. 38; Industrial Trust Co. *v.* South American Co. (1893), W. N. 160; Giles *v.* Nuttall, *Re* House Improvement Supply Assn. (1885), W. N. 51; *Re* Pound, Son, & Hutchins (C. A. 1889), 42 Ch. Div. 402.

declines to direct such a contract to be performed, or, in case it has been repudiated by the receiver, refuses to award damages, at least in the ordinary sense of the term, for its non-performance. If, however, the contractor has in good faith entered into a contract with a receiver clothed with discretionary powers, and before the unreasonableness and improvidence of such contract has been brought to his notice or judicially determined, has expended money or contracted obligations which, if the contract go unperformed, he cannot be protected against, it is obviously equitable that he should not be allowed to suffer any actual loss; and since the receiver merely represents the fund, the claimant should be made whole out of that fund, and not left to such redress as he may be entitled to against the receiver. If the conduct of the receiver require it, the court might compel him to reimburse the fund for what would thus be taken from it.[1]

An example of an unreasonable contract which the court would feel bound to repudiate would be one for the furnishing of supplies for a period so extended as to be manifestly greater than that required for winding up the affairs of the receivership by foreclosure or otherwise. On the other hand, if the contractor, not knowing that the receiver's power is about to be terminated, is proceeding in good faith to perform the contract for supplies, the court, although it will not compel the performance of the contract, or award the contractor damages, will indemnify him against actual loss.[2]

So, if the court has actually sanctioned a contract for supplies, the amount due thereon must be paid without reference to the

[1] The statement in the text is summarized from the opinion in Vanderbilt *v.* Little (1887), 43 N. J. Eq. 669; s. c. 35 Am. & Eng. R. R. Cas. 18. This case was decided with reference to the New Jersey statute, but the reasoning of the court in this part of the opinion seems to be of general application.

[2] Vanderbilt *v.* Little (1887), 43 N. J. Eq. 669; s. c. 35 Am. & Eng. R. R. Cas. 18. In this case certain contracts for the delivery of ties were, upon a review of the circumstances, especially the near approach of the termination of the receivership, held to be improvident; but, as there was nothing to show that the claimants were guilty of bad faith, they were awarded compensation for what they had actually done in preparing for the performance of the contracts up to the time when they were repudiated. The practical result of this decision was to modify the rigorous rule laid down in the trial court in Lehigh Coal & Navigation Co. *v.* Central R. Co. of New Jersey (1882), 35 N. J. Eq. 426; s. c. 9 Am. & Eng. R. R. Cas. 479, and to establish the principle that a chancellor, although he will always refuse to direct the performance of an improvident contract, will not leave the contractor entirely remediless, if he has acted in good faith. The lower court had declined to go any further than to admit that it would be proper to receive the material if it was reasonably necessary for the use of the road in the near future, and was offered at a fair price. The two courts differed as to the effect of the evidence.

question whether such payment will prove injurious to the proper management of the road by the receiver.[1]

Delivery of supplies to the agents of a receiver is sufficient to take a contract out of the Statute of Frauds, so far as regards the liability of the trust fund.[2]

§ 647. **Powers bestowed on Receiver in Order of Appointment liberally construed.** — The powers of a receiver bestowed in the order of appointment are liberally construed in view of the peculiar character of the property which he is authorized to take into his hands.[3]

The details of the business intrusted to a receiver must of necessity be left to his discretion, and to this extent he possesses all the incidental powers requisite to effect the object of his appointment.[4]

The receiver may call in or put out the securities of the company as, in his judgment, will best enable him to secure the property to the stockholders and pay off its creditors, subject always to the check of the court.[5]

The functions of a court during a receivership being essentially preservative in their nature, it follows that, in the case of a railroad, the value of which mainly depends upon its being kept in

[1] Matter of U. S. Rolling Stock Co. (1878), 57 How. Pr. 16.

[2] Vanderbilt *v.* Little (1887), 43 N. J. Eq. 669 ; s. c. 35 Am. & Eng. R. R. Cas. 18.

[3] Langdon *v.* Vermont & Canada R. Co. (1882), 54 Vt. 593 ; s. c. 11 Am. & Eng. R. R. Cas. 688. There the court pointed out in the following words the peculiar features of a railroad receivership, which call for the application of special rules in determining the proper limits of a receiver's powers: "The business in this case was necessarily administrative; the operating of railroads is a thing in its nature continuous and without limitation, requiring in the operation large expenditures from day to day. The duties, also, of such managers, as common carriers, are largely to the public as well as to the parties in interest as owners. It is not, in its character and incidents, like a receivership in an insolvent partnership, or other like business, where the only duty of the receiver is to marshal the assets, pay a dividend to the creditors, and close up the business. The latter are more properly demonstrated receivers; the former, managers, — and a wider discretion must be allowed them, because, at every moment in the administration of such a trust, there is a demand for the exercise of judgment in occurring incidents of vital interest to the property and to the public that cannot be postponed nor evaded. The exactions which the law makes in such cases upon court managers are modified by reason and justice as applied to the nature and character of the trust."

[4] Bank of Montreal *v.* Chicago, C. & W. R. Co. (1878), 48 Iowa, 518.

[5] *In re* Fifty-four First-mortgage Bondholders (1881), 15 S. C. 304, 305 ; 9 Am. & Eng. R. R. Cas. 739. The court in this case said that, if the receiver took up bonds one month, and reissued them the next, to save interest and enable him to meet the current expenses on the most economical scale, he did not thereby destroy the lien of the bonds taken up, which made it a secure investment when originally issued, those bonds being supposed to retain their lien as they pass from hand to hand around the financial circle.

good running order, a receiver is deemed to be vested with all needful authority to operate the road so as to preserve its traffic and connections. That the power of a court of chancery to appoint a receiver of a railroad is derived from a statute which merely confers authority to convert the corporate property into money and distribute it among the creditors is immaterial for the purposes of this rule; for the language of the legislature will receive a construction appropriate to the character of the property, which is such that the cessation of the business would be fatal to the interests of all concerned.[1]

This principle of liberal construction, however, will be applied only to such transactions as may reasonably be classed among those expressly or impliedly embraced in the order of appointment. Thus, a receiver who is merely authorized to make all contracts which may be necessary in carrying on the business of the road, subject to the supervision of the court, has no power to lease offices for a term of years without the sanction of the court.[2]

So, where a receiver is authorized by the terms of his appointment to pay the amounts due and maturing for materials and supplies about the operation and for the use of the road, the implication is that only those obligations are to be paid which are necessary to keep the road in running order; and the court will not extend the construction of the order so far as to direct the receiver to pay old obligations, incurred several years previously. Such demands are regarded as secondary to the rights of the mortgagees.[3]

§ 648. **Power of Court to cease running a Section of a Composite System.** — It would seem that, in extreme cases, a court will not hesitate to authorize its receiver to cease operating a subdivision of the system covered by the general mortgage which is the subject of the foreclosure suit. Such a contingency was discussed in the course of the Wabash litigation, when the system was broken up by the order of the court in another circuit, displacing the original receivers as to all the lines within its jurisdiction. The effect was to leave a number of fragments of the road under the control of the court which had thus far had the whole property under its control, and as these had, with one exception, been run at a dead loss up to the dismemberment of the system, Judge

[1] Vanderbilt *v.* Little (1887), 43 N. J. Eq. 669; s. c. 35 Am. & Eng. R. R. Cas. 18.

[2] Chicago Deposit Vault Co. *v.* McNulta (1894), 153 U. S. 554.

[3] Brown *v.* New York & Erie R. Co. (1860), 19 How. Pr. 84.

Treat said that, unless the receivers were guarantied against loss, they would have to give up running these unprofitable divisions.[1]

§ 649. **Right of Receiver to revoke Running Powers given by the Company to a Connecting Road.** — A receiver is warranted in denying to a connecting road the benefits of a contract by which the latter enjoys the use of the road and certain terminal facilities, where the stipulated compensation is three months in arrears, and it has failed to comply with a demand for the payment even of a portion which has accrued since the beginning of the receivership a full month after it has fallen due. In such a case he is not obliged to apply to the court for instructions, it being evident that he would have been directed to do precisely what he did on his own motion, — namely, require the payment of, or security for, the arrears within a very brief period. The convenience of the public must under these circumstances be subordinated to the rights of those by whom the lines of railroad are owned.[2]

§ 650. **Receiver may be authorized to take a Lease of another Road.** — The receiver may be authorized to take a lease of other roads where such a course is to the advantage of the estate.[3]

§ 651. **Limited Powers of a Receiver appointed for a Special Purpose.** — The powers of a receiver appointed merely to realize profits to pay off arrears of rents are necessarily even more circumscribed than those of one who is appointed with a view to the ultimate sale of the property for the satisfaction of debts of the company generally. The property in the hands of such a receiver must not be subjected to deterioration and waste merely because the current use of it looks especially to the realizing of net income. "It should be kept in proper condition, not only for doing the current business during the receivership, but for continuing to do it, without the necessity for an extraordinary outlay on its passing back to the possession of the owners. But for any legitimate purpose the receivership cannot be extended to the control and maintaining and repairing and equipping other roads, or to the building and buying of other roads, or to the control and operating of lines of steamboats, or steamboats in the lines of other roads, even with the view of larger earnings and larger net income of the property which is the subject of the receivership." [4]

[1] Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1886), 29 Fed. Rep. 618.

[2] Elmira Iron & Steel Rolling Mill Co. *v.* Erie Ry. Co. (1875), 26 N. J. Eq. 284.

[3] Gibert *v.* Washington City, Va. Midl. & Great Southern R. Co. (1880), 33 Gratt. 586; s. c. 1 Am. & Eng. R. R. Cas. 473.

[4] Vermont & Canada R. Co. *v.* Vermont Central R. Co. (1877), 50 Vt. 500; s. c. 14 Am. Ry. Rep. 497.

§ 652. **Control over the Property sometimes reserved by Court after Sale.** — In an order confirming a sale and discharging a receiver, the court may insert provisions for the payment of undisposed of claims against the receiver in the management of the property, and for continuing the lien therefor upon the property. Such an order may also reserve control of the property with a view to enforcing the claims in case the purchaser fails to pay them.[1]

So if the price of rolling-stock, purchased by the receiver, is, by an order of the court, made a lien on "the mortgaged premises, and all proceeds which may come into this court," the intendment is that it is to be a lien on the *corpus;* and, if no proceeds in cash are ultimately realized from the foreclosure sale, that lien will attach to the property in the hands of the purchasers and all assignees without notice.[2]

Where no provision is made in the order of sale for the payment of the debts contracted by the receiver, nor for their assumption by the purchaser, a claim for legal services will not be given the status of a lien debt on the property in the hands of that purchaser. Even if such purchaser recognizes the claim and makes a payment on account, it will stand merely on the footing of other simple contracts. The claimant, therefore, cannot have a charge declared in his favor on the funds in the hands of a receiver appointed in a suit to foreclose a mortgage executed by that purchaser. In such a case it does not avail the petitioner that his services were of such a character as to inure to the benefit of the parties secured by the mortgage.[3]

Article II. — Disposition of the Trust Fund during the Receivership generally.

§ 653. **General Rule as to Expenses of Administration.** — The general rule is that trust estate must bear the expenses of its administration. It is, therefore, the duty of a court which appoints a receiver to pay from the trust fund in its possession all the debts which it incurs in its judicial capacity while administering the trust assumed, pending the litigation, in behalf of the litigating parties.[4]

[1] Farmers' Loan & Trust Co. *v.* Central R. Co. of Iowa (1883), 17 Fed. Rep. 758.

[2] Vilas *v.* Page (1887), 106 N. Y. 439. The court distinguished Railroad Co. *v.* Howard (1868), 7 Wall. 392, where the general rule was laid down that, upon the sale of mortgaged premises, the proceeds became the substitute for the property so far as the lienholders are concerned, and the purchaser takes the land free from their claims.

[3] Bound *v.* South Carolina Ry. Co. (1892), 51 Fed. Rep. 58.

[4] Myer *v.* Car Co. (1880), 102 U. S. 1, 13.

The proceeds and profits of the business in the receiver's hands are subject, in the first place, to the charges of administration and management, and the liens and trusts in behalf of which he was appointed. Neither the railroad company itself, nor any party whose claim is based on the company's rights,[1] nor the bondholders,[2] have a right to any portion of the income in his hands until the expenses of the receivership have been satisfied.

These expenses are, in the first place, payable out of the income; but, if that is inadequate for the purpose, they are chargeable upon the fund produced by the sale of the property.[3]

The operating expenses, which constitute a paramount charge upon the trust fund, are, broadly speaking, those which it is reasonably necessary to incur for the purpose of keeping up the road as a "going concern," or, as it is sometimes expressed, those which conduce to the conservation of the property. The claims to which the priority is accorded form a much more numerous class than those which belong to the category of "preferential debts" (see Chap. XXVII., *ante*). But in determining the justifiable limits of a receiver's outlay, the essentially temporary character of his office is never lost sight of, and many expenditures which the company itself may make without laying itself open to the charge of misapplying the income will neither be authorized nor ratified by a court which assumes control of the company's property.

In one important respect, however, the powers of the court in regard to the expenditures which it does actually consider it legitimate to order are much more extensive than those of the company, as it may, even without the consent of prior incumbrancers, make a loan procured for the purpose of defraying those expenditures a paramount charge on the *corpus* of the estate, if the revenue is insufficient to furnish the necessary funds. See §§ 696 *et seq.*, *post*, as to the scope of this principle.

Judgments against a receiver of a railroad company, in foreclosure proceedings, are considered a part of the operating expenses of the railroad, and have a priority of lien over the mortgages given to secure bondholders.[4]

[1] Schutte *v.* Florida Central R. Co. (1879), 3 Woods, 692.

[2] Langdon *v.* Vermont & Canada R. Co. (1882), 54 Vt. 593; s. c. 11 Am. & Eng. R. R. Cas. 688.

[3] Central Trust Co. *v.* Thurman (1894), 94 Ga. 735; s. c. 20 S. E. Rep. 141.

[4] St. Louis S. W. Ry. Co. *v.* Holbrook (1896), 73 Fed. Rep. 112.

As to the operating expenses of a railroad company for a limited time prior to a receivership having a preference from the subsequent income, and if that is insufficient, from the coupons of the property over bondholders' claims, see Ames *et al. v.* Pacific Ry. Co. *et. al* (1896), 74 Fed. Rep. 335, 344, 345.

§ 654. **Claims against Receivership should be paid before Receiver is discharged.** — A receiver still retains the power to resume possession of the trust estate for the purpose of enforcing all claims to or liens upon it which result from previous orders or decrees. The court being still the proper and only forum to give relief to one having a claim against the receiver, it is judicial error to dismiss a petition praying to have such a claim paid.[1]

§ 655. **Expenses of Company after Appointment of Receiver not a Proper Charge on the Trust Fund.** — A receiver will not be directed to pay the company moneys to be used in contesting the validity of the bonds, or in paying the salaries of the corporate officers, or office expenses incurred by the company after his appointment.[2]

§ 656. **Expenses of Refunding Scheme, when not allowed ex parte.** — Where lien-creditors have become parties to a suit in which a receiver has been appointed, not for the purpose of realizing the property, but merely of preserving it, the court will not allow the expenses of a refunding scheme proposed by the receiver, unless upon notice to the new parties, even though the receiver may have been authorized to incur the liability before the intervention of those parties.[3]

§ 657. **Expenses of carrying out Reorganization Scheme.** — The expenses of carrying out a scheme of reorganization may to a limited extent be defrayed out of the funds of the receivership. Thus under a case involving some peculiar features, where a syndicate had proposed to effect a readjustment of the affairs of the company by the advancement of funds to purchase overdue coupons and interest, the court granted permission to the receivers to pay the syndicate $2\frac{1}{2}$ per cent commission on the money so advanced in case the plan became effective.[4]

§ 658. **When the Payment of Interest on Bonds will be ordered.** — Where the interest on a lien debt is about to mature, the question whether it shall be allowed to go to default must be determined with reference to the interests of the trust estate as a whole. The court will, without hesitation, direct its receiver to pay any interest, default in which would lead to a foreclosure suit and the possible

[1] Thornton *v.* Highland Ave. & B. R. Co. (1892), 94 Ala. 266; s. c. 10 So. Rep. 442.

[2] Union Loan & Trust Co. *v.* Southern California Motor Road Co. (1892), 51 Fed. Rep. 106.

[3] Clarke *v.* Central Railroad & Bkg. Co. (1893), 54 Fed. Rep. 556.

[4] Platt *v.* Philadelphia & Reading R. Co. (1894), 65 Fed. Rep. 872. The report of the master, which was adopted by the court, took the ground that these commissions were only an element of the net price to be obtained for the corporate assets, and that the provision for their payment did not impair the obligation of income mortgages.

loss of valuable parts of the property. Such interest should be paid, even though it is an open question whether any title conveyed by the foreclosure sale would not be subordinate to a mortgage securing the bondholders whose trustee is petitioning to have the receiver instructed. The receiver should not be allowed to speculate upon the decision of another court. The interests of all the creditors, including the bondholders themselves, imperatively demand that no such risk shall be taken.[1]

The court will direct a receiver appointed at the instance of subordinate creditors to pay the interest on first-mortgage bonds, where such disposition of the funds is desired by them, and the circumstances show that it is to the interest of all creditors inferior in rank to the holders of the first-mortgage bonds that the maturity of those bonds shall not be precipitated.[2]

If necessary the court may even authorize a loan for the purpose of paying such interest, and make such loan a charge on the surplus earnings of the road, ranking next after claims for operating expenses, and a lien upon the *corpus* subordinate only to the first-mortgage bonds and to the claims that may be adjudged superior thereto.[3]

But it has been held that interest on bonds secured by a prior divisional mortgage should not be paid at the request of the trustee of a junior consolidated mortgage, when the reasons urged for granting this relief are merely that such trustee will be enabled to foreclose the general mortgage, and procure a comprehensive decree, and that the preferential creditors would thus be placed in a more favorable position. The court took the ground that it was its first duty to pay, as soon as it reasonably could, the indebtedness incurred by it since the appointment of the receiver, and that it would be unjust at that time to the unsecured creditors to make any further diversion of the earnings to the payment of interest.[4]

[1] Park *v.* New York, L. E. & W. R. Co. (1894), 64 Fed. Rep. 190.

[2] Lloyd *v.* Chesapeake, O. & S. W. R. Co. (1895), 65 Fed. Rep. 351.

[3] Ibid.

[4] Cleveland, C. & S. R. Co. *v.* Knickerbocker Trust Co. (1894), 64 Fed. Rep. 623. In this case the court suggested that, if the advantages to accrue to the petitioner were as great as represented, he might properly advance the necessary money and pay off the interest, and then assert his right to be subrogated to the claims of the first four mortgage bondholders upon the trust fund. The court admitted the soundness of the ruling in the first case cited in this section; but it is not easy to see why its suggestion is not equally pertinent to the circumstances of that case as well, for it would certainly seem that the benefit to be derived by preventing the dismemberment of a system has some money value to the creditors, who will suffer most from the resulting depreciation of the property. The distinction implied in the opinion would therefore appear to be an unsub-

As funded coupon-bonds, investing the holders with all the rights of the holders of the defaulted coupons which they replace, are necessarily payable before any subsequent instalments of interest, the receiver should be directed to pay the coupon-bonds in preference to any of the later coupons.[1]

§ 659. **Property in the Hands of a Receiver not exempt from Taxation.** — There is no sound principle upon which the property of a person or a corporation which is placed in the hands of a receiver by a court of justice, for the purposes of a suit pending in such court, can be regarded as being thereby rendered exempt from the operation of the tax laws of the government within whose jurisdiction such property is situated.[2]

The State has, therefore, a paramount right to collect out of the gross income of the receivership all taxes which the corporation itself would have been obliged to pay if it had remained in possession, and the receiver may recognize this paramount right by paying the taxes which become due while he is in charge of the property.[3] (As to the proper and allowable procedure for enforcing this paramount claim, see Chap. XXVIII.)

As to the allowance of the receiver's personal compensation and of the fees of his counsel, see Chap. XXX., *post.*

§ 660. **What will be allowed as Operating Expenses in a Receiver's Accounts. General Principle.** — It has been shown that it is sometimes the duty, and always the right, of the receiver to consult the court as to the management of the property in a doubtful case. If he omits to do this, he will not be allowed in his accounts any expenses except those which were absolutely essential

stantial one. Dismemberment, after all, is only one of the ways in which the trust property may be depreciated, and possibly the only question which it is necessary to ask, in the case of an application to have the interest on bonds paid, is whether the amount of money finally available for all the creditors will be increased by such payment. The answer to this question necessarily includes an answer to the question emphasized by the court in this case; viz., whether the position of the creditors of the receivership and of those holding preferential claims will be jeopardized by the payment; for if the trust fund as a whole is increased, their position must necessarily be improved. It seems to us a very dubious doctrine that the court should, merely for the sake of being able to discharge these paramount claims at an earlier date, sacrifice the interest of all the other creditors. Yet this is perhaps the only reason that can be urged against the course here suggested.

[1] Park *v.* New York, L. E. & W. R. Co. (1894), 64 Fed. Rep. 190.

[2] Stephens *v.* New York & Oswego Midland R. Co. (1875), 13 Blatch. 104; S. P. State of New Jersey, New Jersey Southern R. Co., Prosecutor, *v.* Railroad Commissioners (1879), 41 N. J. L. 235.

[3] Central Trust Co. *v.* New York City & Northern R. Co. (1888), 110 N. Y. 250; S. C. 18 N. E. Rep. 92; 13 Centr. Rep. 484; *In re* Tyler (1893), 149 U. S. 164; Greeley *v.* Provident Sav. Bank (1889), 98 Mo. 458; High on Rec., § 140, note.

for the preservation and use of the property, as contemplated by his appointment.[1]

The principles upon which it will be determined whether any given expenditure comes within the limits thus prescribed have been thus stated by Mr. Justice Bradley : " It may be laid down as a general proposition that all outlays made by the receiver in good faith, in the ordinary course, with a view to advance and promote the business of the road, and to render it profitable and successful, are fairly within the line of discretion which is necessarily allowed to a receiver intrusted with the management and operation of a railroad in his hands.

" His duties, and the discretion with which he is invested, are very different from those of a passive receiver, appointed merely to collect and hold moneys due on prior transactions or rents accruing from houses and lands. And to such outlays in ordinary course may properly be referred not only the keeping of the road, and rolling-stock in repair, but also the providing of such additional accommodations, stock, and instrumentalities as the necessities of the business may require."[2]

§ 661. **Allowable Expenses for Supplies.** — Allowable expenditures for supplies include not merely those incurred for articles used in the actual operation of the road, such as fuel, etc., but for all the accessories which are commonly used for the transaction of the business of a company engaged in the transportation of passengers and freight. A receiver may, therefore, purchase scales, where they are reasonably necessary for the use of the road, and there is no ground for imputing improvidence in making the purchase. He is also warranted in buying a truck wagon and horses for the delivery of freight, and incurring the expense of maintaining the same, the proof being that this was a profitable outlay for enabling the railroad, by furnishing additional accommodation to customers, to compete with an opposition line.[3]

Expenditures for rails are among those which should perhaps be made only under the authority of the court; but, if upon a proper investigation they seem to have been proper, the court will not refuse to confirm them.[4]

[1] Cowdrey *v.* Galveston, H. & H. R. Co. (1876), 93 U. S. 352, per Bradley, J. Compare Crumlish's Admrs. *v.* Shenandoah Valley R. Co. (1895), 40 W. Va. 627 ; s. c. 22 S. E. Rep. 90.

[2] Cowdrey *v.* Railroad Co. (1870), 1 Woods, 331. In Brocklebank *v.* The East London Ry. Co. (1879), 48 L. J. Eq. N. S. 729, Fry, J., held that stranger to action could not apply for order to receiver directing him to pay working expenses.

[3] Cowdrey *v.* Railroad Co. (1870), 1 Woods, 331.

[4] Phinizy *v.* Augusta & K. R. Co. (1894), 62 Fed. Rep. 771.

§ 662. **Office Rent.** — Office rent will be allowed where the accommodation is not shown to be excessive.[1]

§ 663. **Interest on Money borrowed by Receiver.** — Interest on money which the receiver is obliged to borrow in order to keep a railroad in operation is necessarily a legitimate charge against the trust fund if the loan itself was, within the scope of his authority.[2]

§ 664. **Interest paid on Bonds.** — Money applied to the payment of interest on the bonds of a subordinate road forming a part of the entire system administered by the receiver will be admitted as a valid claim in his favor, ranking next after the sum necessary to satisfy the bonds and coupons secured by prior mortgages.[3] (As to when the payment of bonded interest will be ordered, see sect. 658, *ante.*)

§ 665. **Expenditures usual in Business with a Subordinate Road.** — The fact that certain expenditures are usual in the business of carrying on a railroad will sometimes be a sufficient justification for incurring them. In this category have been placed payments made by receivers to connecting roads for moneys due to and previously received for them, according to the customary practice;[4] and rebatements on freight, or allowances returned to shippers in consideration of securing their business and good-will to the road, there being proof that such allowances were quite commonly made by transportation lines, and that they were necessary in the given case in order to secure business, as this method of attracting customers had been previously adopted by the companies.[5]

§ 666. **Expenditures to prevent Construction of Rival Road not allowed.** — Expenditures incurred to defeat a subsidy which a rival company is trying to obtain from a city will be disallowed in a receiver's accounts. It is no part of his duty to interfere with the construction of a parallel line of railway, or to attempt to defeat any contemplated aid for such an enterprise. The fact that the success of the enterprise may possibly diminish the future earnings of the company whose road is in his charge will not justify such an outlay. As an officer of the court, the receiver cannot be allowed to determine the question of the importance of the proposed lines, either to the public or to the company, and,

[1] Cowdrey *v.* Railroad Co. (1870), 1 Woods, 331.

[2] Ibid.

[3] Phinizy *v.* Augusta & K. R. Co. (1894), 62 Fed. Rep. 771.

[4] Meyer *v.* Johnston (1882), 64 Ala. 603; s. c. 8 Am. & Eng. R. R. Cas. 584.

[5] Cowdrey *v.* Railroad Co. (1870), 1 Woods, 331.

acting upon such determination to appropriate funds in his custody, to aid or defeat the competing road; that they actually had the effect of securing a large amount of business, and that without them the road would not have paid expenses, will not warrant the allowance of such an item.[1]

§ 667. **Receiver's Power to make Purchases on Credit.** — A receiver authorized by the decree appointing him to run a hotel, and for that purpose to make such purchases as may be necessary, has the implied authority to purchase the necessary supplies for the hotel on credit, where he has no money on hand, and no provision was made by the court for raising any.[2]

One selling goods to a receiver vested with authority to purchase goods on credit, if without funds, is not bound to know that at the time of the purchase the receiver had funds available therefor.[3]

§ 668. **Liabilities arising from the Contracts of the Company adopted by the Receiver.** — Liabilities arising from the contracts of the company which are adopted by a receiver must, of course, be reckoned among the operating expenses to be provided for out of the trust fund. To this category belong the sums due to other companies for rent of track, under leases ratified by the receiver, and the amounts to be paid for the rent of rolling-stock, hired by the company and used by the receiver.[4]

If the rolling-stock so used is subject to a vendor's lien, the rental for its use will be a prior charge on the proceeds of the sale, and not merely on the earnings.[5] (As to the effect of the appointment of a receiver on the rights and liabilities arising from car trusts and other conditional sales of rolling-stock, see Chap. XV.)

§ 669. **Liabilities arising out of Torts incident to the Operation of the Road.** — Liabilities arising out of torts incident to the operation of the road by the receiver constitute an obligation against

[1] Cowdrey *v.* Galveston, H. & H. R. Co. (1876), 93 U. S. 352. Compare *In re* Mersey Ry. Co. (1895), 64 L. J. Ch. 623, expenses for promotion of bill in Parliament, not "working expenses" or "other proper outgoings in respect of the undertaking."

[2] Thornton *v.* Highland Ave. & B. R. Co. (1892), 94 Ala. 353; s. c. 10 So. Rep. 442.

[3] Highland Avenue & Belt R. Co. *v.* Thornton (1894), 105 Ala. 225; s. c. 16 So. Rep. 699.

[4] United States Trust Co. *v.* Wabash Western Ry. Co. (1892), 150 U. S. 287; Union Trust Co. *v.* Illinois Midland Ry. Co. (1887), 117 U. S. 434; s. c. 25 Am. & Eng. R. R. Cas. 560; Thomas *v.* Western Car Co. (1892), 149 U. S. 95, 110; Kneeland *v.* American Loan & Trust Co. (1890), 136 U. S. 223; s. c. 43 Am. & Eng. R. R. Cas. 102.

[5] Kneeland *v.* American Loan & Trust Co. (1891), 138 U. S. 509; s. c. 43 Am. & Eng. R. R. Cas. 520.

the trust-funds which must be discharged before the bondholders are entitled to any part thereof.[1]

Claims based upon such liabilities stand on the same footing as the other expenses of administration.[2]

For the purposes of this rule it is immaterial whether the claims have been reduced to judgments or not.[3]

But until they are actually reduced to judgment by a suit against the receiver, and the amount due definitely fixed, they will not bear interest.[4]

Claims for damages resulting from the operation of the road are a charge on the earnings of the receivership only.[5]

§ 670. **Compensation to Injured Employees, to what Extent proper.** — The doctrine that receivers, as officers of the court, should be required to act toward their employees as persons of ordinary humanity and right feeling would act under similar circumstances has been adduced to justify the allowance of compensation to an employee injured by a fellow-servant's negligence for the time lost while he is incapacitated from working.[6]

But such an allowance should be made only to faithful and deserving employees, who merit special consideration from the receiver. To hold him legally liable to make compensation in every case, irrespective of the question of his own negligence, would engraft a new principle on our jurisprudence.[7]

§ 671. **Consolidated System of Roads administered as an Entirety.**[8] — In administering a consolidated property made up of several lines, the court must consider not merely the interest of the mortgagee in a general mortgage, but also the separate, and sometimes conflicting, interests of the various subdivisions and their respec-

[1] Cowdrey *v.* Galveston, H. & H. R. Co. (1876), 93 U. S. 352, where compensation to the owners of goods lost in transportation, and compensation paid for damages to property during the receivership, were allowed by the court in the receiver's accounts.

[2] Kain *v.* Smith (1880), 80 N. Y. 458; Mobile & Ohio R. Co. *v.* Davis (1884), 62 Miss. 271; s. c. 26 Am. & Eng. R. R. Cas. 425.

[3] Gibbes *v.* Greenville & Columbia R. Co. (1882), 18 S. C. 87; s. c. 17 Am. & Eng. R. R. Cas. 302.

[4] Gibbes *v.* Greenville & Columbia R. Co. (1882), 18 S. C. 87; s. c. 17 Am. & Eng. R. R. Cas. 302. In that case judgment had been taken against the *company*, while there was a *quasi* receivership of the property under the management of the officers, and afterwards made the subject of petition to a court which took direct control by a regularly appointed receiver.

[5] Hand *v.* Savannah & Charleston R. Co. (1881), 17 S. C. 219; s. c. 12 Am. & Eng. R. R. Cas. 495; Ryan *v.* Hays (1884), 62 Tex. 42; s. c. 23 Am. & Eng. R. R. Cas. 501.

[6] Missouri Pac. Ry. Co. *v.* Texas Pac. Ry. Co. (1888), 33 Fed. Rep. 701; 41 Fed. Rep. 319 (1890).

[7] Thomas *v.* East Tennessee, V. & Ga. Ry. Co. (Cook, Intervener), (1894), 60 Fed. Rep. 7, limiting the case just cited.

[8] Compare previous references to subject.

tive incumbrances, and behind all that the duty which every railroad corporation owes to the public of keeping the road in operation. That duty is not limited to the operation merely of that particular fragment of a road which is peculiarly profitable, but it extends to the road as an entirety, and to all its parts; differing in that particular from the duty which would rest upon the court if it had simply taken possession of property used for private purposes, in which case the single question might well be said to be one of pecuniary profit.[1]

Claims for the rent of separate subdivisions of a corporate system of roads, if based upon an order which is expressly subordinated to a former order directing the payment of the expenses of the receivership, and of certain preferential debts of the lessor, can never be enforced unless there is a surplus after paying the debts thus provided for. Hence, as long as the avails of the property are insufficient to discharge such debts, it is improper to direct the receiver to pay the rent of a branch which is earning more than its operating expenses.[2]

On the other hand, it has been held that, as a court which takes possession of and operates a leased line together with the rest of the property does this for the benefit of the lessee, not of the lessor, no part of the expenses of the receivership can properly be charged against the property of the lessor.[3]

[1] Central Trust Co. *v.* Wabash, St. Louis, & Pac. Ry. Co. (1885), 23 Fed. Rep. 863, per Brewer, J.

In that case the learned judge laid down the following rules as being appropriate under the circumstances: (1) When a division earns a surplus over expenses, the rental or subdivisional interest should be paid to the extent of the surplus, and only to that extent; and if there has been any past division of that surplus for general operating expenses, it should be made good by the issue of receiver's certificates, if need be. (2) Where a subdivision earns no surplus, and simply pays operating expenses, no rental or subdivisional interest should be paid. (3) Where a subdivision fails to pay operating expenses, the strictest economy should be practised, with a view of keeping the outlay within the receipts; but, if there should still be a deficiency after every expedient for saving money has been tried, it must be paid out of the general earnings of the system, or, if necessary, by the issue of receiver's certificates.

Where, under a decree of foreclosure against a railroad company, reference had been made to a master to ascertain the gross earnings and expenses of a certain section of the road covered by a mortgage, it is not an erroneous principle for the master to make a *pro rata* estimate of the earnings and expenses of the whole road, it being shown before him that such section had not been operated separately, but as a part of the whole road, and no separate accounts kept of the income or expenses of any particular part. Though such a rule leads, not to actual results, but to approximation merely, it is the best which could be adopted. Pullan *v.* Cincinnati & Chicago Air Line R. Co. (1873), 5 Biss. 237.

[2] Central Trust Co. *v.* Wabash, St. Louis, & Pac. Ry. Co. (1889), 38 Fed. Rep. 63, reversing s. c. (1888), 34 Fed. Rep. 259.

[3] Brown *v.* Toledo, P. & W. R. Co. (1888), 35 Fed. Rep. 444.

Where, in proceedings to foreclose a general mortgage in a composite system, it appears that the several divisions have received the advantage of the use of certain leased lines and terminal facilities, and it is impossible to separate the several interests as to expenditures and benefits, the rents will be apportioned among the several divisions on the basis of the relative length of the roads. Bondholders secured by a divisional mortgage who withheld their assent from the transactions resulting in the consolidation of the lines, and the issue of the general mortgage which is the subject of the suit, will be estopped to question the propriety of such an apportionment if they remain inactive, and allow the court and the receivers to go on, during the entire litigation, contracting debts on the theory that the whole line is to be operated as a unit.[1]

As the company which has obtained control of the property of another, and operated it as a subdivision of an extensive system, not under any contractual relation, but solely by virtue of the voting power acquired by the purchase of stock, cannot look to its controlled subordinate for reimbursement for money advanced in operations conducted for the benefit of the controlling company, so a receiver appointed to take the place of the latter is in no better position, and must, as against creditors secured by a mortgage on the subordinate line, bear the loss which may result from its operation, as part of the system which he was appointed to preserve.[2]

§ 672. **Restoration of Earnings diverted from the Payment of Operating Expenses during the Receivership.** — The principle that the operating expenses are a paramount charge on the income of the receivership involves the corollary that, if the fund available for the payment of operating expenses proves to be inadequate at any time for that purpose, because of the application of the earnings to expenses of some other kind, the court will treat the case as one of diversion, to be rectified, by ordering the stoppage of every outlay which does not belong to the favored class until the preferred creditors are fully paid off.[3]

If the earnings have been devoted by the receiver to making

[1] Union Trust Co. *v.* Illinois Midland Ry. Co. (1887), 117 U. S. 434; s. c. 25 Am. & Eng. R. R. Cas. 560.

[2] Phinizy *v.* Augusta & K. R. Co. (1894), 62 Fed. Rep. 771.

[3] Frank *v.* Denver & Rio Grande Ry. Co. (1885), 33 Fed. Rep. 123. In this case the court had authorized the receiver to continue the payments under a contract of conditional sale of rolling-stock, but as it appeared that some payments had been made during the receivership at the expense of the labor and supply creditors, it was ordered that the payments should be suspended until the claims of the latter were satisfied.

permanent improvements so that the value of the bondholder's security has been enhanced, the restoration of those earnings to the current debt fund may be effected, even by making the claims for operating expenses a lien on the *corpus.*[1]

A similar rule applies to cases in which the payment of back claims, which would, in the regular course of procedure, be discharged out of the income, is postponed in order to bring the road into a fit condition for traffic.[2]

The use of earnings in making permanent improvements is a diversion of the earnings as against claimants for damages caused by the operation of the road by the receiver, and if the property is subsequently returned to the possession of the mortgagor company while such damages remain unpaid, an action may be maintained against it for the recovery of the amount thus diverted.[3]

(As to the restoration of earnings diverted prior to the receivership, see Chap. XXVII., § 16.)

Article III. — Power of Receiver to raise Money for the Payment of Operating Expenses by the Issue of First-lien Certificates.

§ 673. **The Receiver cannot, of his own Motion, contract Debts chargeable upon the Fund in Litigation.** — The court must authorize

[1] Thomas *v.* Peoria & R. I. R. Co. (1888), 36 Fed. Rep. 808; s. c. 36 Am. & Eng. R. R. Cas. 381; Union Trust Co. *v.* Illinois Midland Ry. Co. (1887), 117 U. S. 434; s. c. 35 Am. & Eng. R. R. Cas. 582; Burnham *v.* Bowen (1883), 111 U. S. 776.

[2] Turner *v.* Indianapolis, B. & W. Ry. Co. (1878), 8 Biss. 315. Judge Drummond said: "In general, when the mortgagees have come before the court to ask for the appointment of a receiver, the property has been in a very dilapidated condition, the rails nearly worn out, the ties needing replacement, the rolling-stock, station houses, and bridges, repairs, — the whole property being in a condition to render the transit of persons and merchandise dangerous. The practice has therefore been, instead of immediately directing the receiver to pay for labor or supplies, or materials previously furnished, to expend the receipts in repairs of the road, in the purchase of new iron or steel and of rolling-stock, and in the construction and repair of side-tracks, bridges, station houses, etc., thus adding to the security of the mortgagees by enhancing the value of the property. It has been thought that, under the same equitable discretion which has been heretofore referred to, this gave the operatives and material-men a *quasi* claim upon the property itself. It has not unfrequently happened that railroads which were comparatively worthless when they came into possession of the court have become, under its administration, valuable property. But under the more modern practice, the funds for this purpose would doubtless be obtained by the issue of receiver's certificates, so that the labor and supply creditors might not be forced to await the distribution of the proceeds of the sale."

[3] Tex. & Pac. Ry. Co. *v.* Bloom (1894), 60 Fed. Rep. 979, citing Railroad Co. *v.* Johnston (1894), 151 U. S. 81; s. c. 14 Sup. Ct. Rep. 250.

expenditures on account of the property before they can be charged thereon; and while it may, and does, in its discretion, allow expenses incurred by a receiver strictly for preservation to be charged upon the fund, although incurred without the prior authorization of the court, it is nevertheless the order of the court, and not the act of the receiver, which creates the charge, and on which its validity depends.[1]

The view sanctioned by the Supreme Court of the United States would seem to be that one who lends money to the receiver to pay operating expenses is not necessarily precluded from obtaining reimbursement out of the proceeds of the *corpus*, merely because the loan has not previously been authorized by the court, but that the creditor, unless the authorization is given, runs the risk of the court's refusing to allow his claim any precedence over the bonds.[2]

§ 674. **Expenses of Management sometimes made a First Lien on the Property by Order appointing Receiver.** — The expenses of the management may be made to constitute a lien on the property paramount to the mortgage by inserting a special provision to

[1] Vilas *v.* Page (1887), 106 N. Y. 439. In Union Trust Co. *v.* Chicago & Lake Huron R. Co. (1881), 7 Fed. Rep. 513, the court, arguing that the doctrine stated in the text was the correct one, declared that the negotiation of the certificates was a personal trust which could not be delegated.

[2] Union Trust Co. *v.* Illinois Midland Ry. Co. (1887), 117 U. S. 434; s. c. 25 Am. & Eng. R. R. Cas. 560. There the court ruled that a loan made by the receiver to pay operating expenses could not be charged as a first lien on the trust estate, on the ground that it was too large to fall within the conceded discretionary powers of the receiver in regard to outlays. This rule is perhaps more conformable with reason and justice than the more rigorous one applied in South Carolina, where it has been denied that labor claims against the receiver can be charged upon the proceeds of the sale, in cases where the income is insufficient to liquidate them, unless they are secured or provided for in some way by receiver's certificates issued under the authority of the court. Such claims, it was said, were simply "debts contracted with a receiver, limited in authority of an insolvent railroad, known to be covered with mortgages, and not making expenses." Hand *v.* Savannah & Charleston R. Co. (1880), 17 S. C. 219; s. c. 12 Am. & Eng. R. R. Cas. 495. The court, in Union Trust Co. *v.* Illinois Midland Ry. Co. (1887), 117 U. S. 434; s. c. 25 Am. & Eng. R. R. Cas. 560, considered itself to be bound by the terms of the order of appointment which contemplated the payment of expenses out of the income only. As to the latter objection, it seems clear, on principle and authority, that the terms of an order of appointment do not limit the power which a court would otherwise have to order claims to be paid out of the proceeds of the property itself. Nor is it entirely clear why the case is not a proper one for applying the principle that the subsequent ratification of the court should be held to have the same effect as a prior authorization. Those who contract with an agent of limited powers are always entitled to take the risk that, if the contract is in excess of his powers, his principal will validate it by a subsequent sanction; and there is no adequate reason, it would seem, for denying the benefit of this rule to parties dealing with receivers.

that effect in the order appointing the receiver, and requiring the assent of the bondholders thereto as a condition of making the appointment. "In its efforts to coerce a corporation to pay its debts, a court should not contract obligations of its own, and neglect to make provision for their payment."[1]

An issue of certificates is sometimes ordered at the commencement of the receivership to pay back claims for labor, supplies, etc.[2]

But there cannot be made a charge on the earnings, except in the cases adverted to below. But, generally speaking, the issue of these instruments of indebtedness is authorized, upon a special application made by the receiver, at some time subsequent to his appointment.

Loans to pay operating expenses cannot be made a lien on the *corpus*, where the statute under which the receiver was appointed declares that they shall be paid out of earnings.[3]

§ 675. **General Principles upon which the Power to issue First-lien Certificates depends.** — The peculiar nature of the property to be administered in the case of a railroad receivership has been held to justify any extremely liberal application of the doctrine that a court may authorize a receiver to do whatever is necessary for the preservation of the estate placed in his charge. Both the theory that the principal value of a railroad consists in its being kept up as a "going concern," and the theory that the right of the public to have the traffic carried on continuously is paramount to the interests of the lien-creditors, have been declared to point logically to the conclusion that, if the income which the receiver obtains from the operation of the road is insufficient to pay current expenses, the court may empower him to make up the deficiency by issuing certificates or other evidences of debt, which shall be a charge on the *corpus* superior to all existing liens.[4]

[1] Dow *v.* Memphis & Little Rock R. Co. (1884), 20 Fed. Rep. 260, 269; s. c. 17 Am. & Eng. R. R. Cas. 324.

[2] Central Trust Co. *v.* Wabash, St. Louis, & Pac. R Co. (1885), 23 Fed. Rep. 863; Wallace *v.* Loomis (1877), 97 U. S. 146.

[3] State of Tennessee *v.* Edgefield & Kentucky R. Co. (1880), 6 Lea (Tenn.), 353; s. c. 4 Am. & Eng. R. R. Cas. 86.

[4] Wallace *v.* Loomis (1877), 97 U. S. 146; Miltenberger *v.* Logansport Ry. Co. (1884), 106 U. S. 286; s. c. 12 Am. & Eng. R. R. Cas. 464; Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467. In the case of a land and cattle company, where the power was asked to be exercised to pay taxes and get crops in, Barnes, J., said: "Whence is the jurisdiction to allow the receiver to borrow denied? And the trustee for the debenture-holders replied, 'It is, we submit, interest in the court; we do not know how else it arises.'" Murrietta *v.* Nevada, L. & C. Co. (1892), 68 Law Times, 442.

This doctrine has, however, elicited

The double basis on which this doctrine rests is very clearly brought out in the following passage from the opinion of Mr. Justice Blatchford in an important case: "Property subject to liens, and claims and debts of various characters and ranks, which is brought within the cognizance of a court of equity for administration and conversion into money and distribution, is a trust fund. It is to be preserved for those entitled to it. This must be done by the hands of the court through officers. The character of the property gives character to the peculiar species of preservation which it requires. A railroad and its appurtenances is a peculiar species of property. Not only will its structures deteriorate and decay and perish, if not cared for and kept up, but its business and good-will will pass away if it is not run and kept in good order. Moreover, a railroad is a matter of public concern. The franchises and rights of the corporation which constructed it were given not merely for private gain to the corporators, but to furnish a public highway; and all persons who deal with the corporation as creditors or holders of its obligations must necessarily be held to do so in the view that, if it falls into insolvency, and its affairs come into a court of equity for adjustment, involving the transfer of its franchises and property, by a sale, into other hands, to have the purpose of its creation still carried out, the court, while in charge of the property, has the power, and under some circumstances it may be its duty, to make such repairs as are necessary to keep the road and its structures in a safe and proper condition to serve the public." [1]

some vigorous protests. The most weighty reason against it is that it undoubtedly deprives the bondholders of a vested right without compensation, and thereby infringes a well-known constitutional provision. The answer to this objection is that bondholders are assumed to accept their security subject to the implied limitation that their interests are to be subordinated to the right of the public to have the road operated continuously. But it cannot seriously be contended that this hypothesis is, as regards mortgagees whose security was created before the view of the paramount right of the public obtained currency, more than a legal fiction coined to fit the peculiar circumstances of these receiverships. There is no little hardship in visiting upon creditors the penalties of a law the existence of which could not even have been suspected by any one not possessed of the gift of prophecy. Nor can it be denied that there is much force in the consideration that, if there be this great public inconvenience in the stoppage of a railroad, it would be fairer that the public itself should provide for obviating this inconvenience by appropriate legislation, or even constitutional amendment, than that the burden should be thrown on a few private individuals. See the remarks of Judge Walker in his dissenting opinion in Humphreys *v.* Allen (1882), 101 Ill. 490, 501; s. c. 4 Am. & Eng. R. R. Cas. 14.

[1] Union Trust Co. *v.* Illinois Midland R. Co. (1887), 117 U. S. 434; s. c. 25 Am. & Eng. R. R. Cas. 568.

The same doctrine has been more briefly expressed in another case, where it was said that authority to issue receivers' certificates is based on the ground that it is necessary to keep the road a going concern, and in order to do so it is for the benefit of the bondholder, as well as a duty to the sovereign whose franchise the bondholders desire to operate, that it should be kept in proper condition.[1]

In an oft-cited Alabama case,[2] the power to issue first-lien certificates is rested entirely upon the public character of functions discharged by railroad companies. On page 348 it was said: "If it were not for the public quality belonging to them, for the injury that would be done to the interests of whole communities that have become dependent on a railroad for accommodation in a thousand things, a chancellor might say to the parties most interested, Unless you furnish means for the protection of this property, which does not itself afford an adequate income for the purpose, it may become a dilapidated and useless wreck. But the inconvenience and loss which this would inflict on the population of large districts, coupled with the benefit to parties who perhaps are powerless to take care of themselves of preventing the rapid diminution ot value, and derangement and disorganization that would otherwise result, seem to require — not for the completion of an unfinished work, or the improvement, beyond what is necessary for its preservation, of an existing one, — but to keep it up, to conserve it as a railroad property, if the court has been obliged to take possession of it, that the court should borrow money for that purpose, if it cannot otherwise do so in sufficiently large sums, by causing negotiable certificates of indebtedness to be issued constituting a first lien on the proceeds of the property, and redeemable when it is sold or disposed of by the court."

So also, in a recent case, Mr. Justice Brewer has referred, *arguendo*, to the obligation of continued operation which railroad property must discharge to the public, as being the foundation, of the power of the court to make the expenses of a receivership a prior lien of the *corpus* of the estate.[3]

§ 676. **Purchasers take the Property Subject to Lien for Operating Expenses, when.** — The power of the court to create debts for payment of operating expenses does not cease until the title has

[1] Blair *v.* St. Louis, H. & K. R. Co. (1885), 25 Fed. Rep. 232.

[2] Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467.

[3] Kneeland *v.* American Loan & Trust Co. (1890), 136 U. S. 89; s. c. 43 Am. & Eng. R. R. Cas. 519.

actually passed to the purchasers at the foreclosure sale, and, if the latter neglect for several years to complete the sale, they will take the property subject to the lien created in favor of a vendor of rolling-stock which was acquired in pursuance of an order issued after the sale had been made upon interlocutory judgment, but before it had been confirmed.[1]

A receiver of a system consisting of several lines is entitled to be allowed his expenditures for the purchase of rails for any part of the system, but the outlay is to be charged upon the entire line, and subordinated to the lien of any mortgage there may be upon the line where the rails are used, — at least where the trustees of such mortgage have had no part in the receivership.[2]

The receivers of a system of railroad companies, composed of various roads, are entitled to reimburse themselves, where one of the component companies has failed to equal in revenue the amount they may have expended in operating it, for the deficiency, out of the *corpus*, in preference to bondholders of the company.[3] This upon the principle that receivers cannot divert the income or property of a system of railroads in their charge from its creditors and stockholders to pay the deficit of one of the constituent companies, the property of the system being a trust in their hands for the benefit of its own creditors and stockholders.

§ 677. **Lien of Certificates when not transferred to Proceeds of Sale.** — The lien of receivers' certificates is not transferred to the proceeds of the foreclosure sale, when the purchasers pay in only enough money to meet the costs and other expenses of the case, and for the residue of the price turn in bonds, and the decree confirming the sale directs the conveyance to be made subject to the payment of any sums which the court may thereafter direct to be paid in cash on account of the purchase-money.[4]

§ 678. **Issue of Certificates to pay Operating Expenses may be authorized without the Consent of the Lien Creditors.** — It is well

[1] Vilas *v.* Page (1887), 106 N. Y. 439; s. c. 13 N. E. Rep. 743.

[2] Phinizy *v.* Augusta & K. R. Co. (1894), 62 Fed. Rep. 771.

[3] Ames *et al.* *v.* Union Pac. Ry. Co. *et al.* (1896), 74 Fed. Rep. 335.

[4] Mercantile Trust Co. *v.* Kanawha & Ohio R. Co. (1892), 50 Fed. Rep. 874. Compare Vilas *v.* Page (1887), 106 N. Y. 439. In the latter case the court said: "It could not have been the intention of the court to make a constructive payment on a purchase by the mortgagees, through a cancellation of the mortgage debt, equivalent to an actual payment, so as to relieve the property of the charge. Such a lien would be illusory merely, having no substantial quality."

settled that the power of a court to make a receiver's certificates issued to raise money for the preservation of the road a paramount lien thereon does not depend upon the consent of those who hold prior liens.[1]

In Greenwood *v.* Algeciras (Gibraltar) Ry. (1894), 7 Reports Ch. App. 620, Kekewich, J., although of opinion that it would be to the advantage of all concerned in the company that the order should be made, declined to make it, inasmuch as he doubted whether the court had jurisdiction to do so unless all the debenture-holders who were formally represented in the actions were personally present, having regard to the fact that the money, if raised, would have priority over the existing debentures. On appeal, Lindley, L. J., said that the orders which have been made in previous cases justified the court in acceding to the application. (See cases cited.)

Such consent is desirable,[2] but, in the nature of the case, can rarely be practicable where, as so often occurs, the debts exceed the value of the property.[3]

Where the counsel who makes the application represents all the holders of one class of bonds, and a large proportion of the holders of another class, and the trustees of both mortgages have expressed their desire that the certificates shall be issued, the court will be fully justified in making the necessary order.[4]

As the trustees represent the bondholders in proceedings affecting the mortgage lien,[5] and the receiver represents the company, neither the company nor the bondholders can assail the validity of an order authorizing the purchase of rolling-

[1] Wallace *v.* Loomis (1877), 97 U. S. 146, 162; Union Trust Co. *v.* Illinois Midland Ry. Co. (1887), 117 U. S. 434, 455; s. c. 25 Am. & Eng. R. R. Cas. 560; Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467; Vilas *v.* Page (1887), 106 N. Y. 439. Vermont & Canada R. Co. *v.* Vermont Central R. Co. (1877), 50 Vt. 500; s. c. 14 Am. Ry. Rep. 497, is apparently *contra;* but the court in that case was not dealing with a technical receivership looking to a final sale, the appointment having been made in pursuance of an agreement between the parties, and merely for the purpose of realizing profits to pay arrears of rent.

Receivers' certificates are, by the order authorizing their issue, usually made a first lien on the income, revenues, and earnings of the railroad company, after deducting therefrom the operating expenses, and all other property of the company, real and personal. See, for example, Turner *v.* Peoria & Springfield R. Co. (1880), 95 Ill. 134; s. c. 1 Am. & Eng. R. R. Cas. 348.

[2] Wallace *v.* Loomis (1877), 97 U. S. 146.

[3] Union Trust Co. *v.* Illinois Midland Ry. Co. (1887), 117 U. S. 434, 455; s. c. 25 Am. & Eng. R. R. Cas. 560.

[4] Hoover *v.* Montclair & Greenwood Lake Ry. Co. (1878), 29 N. J. Eq. 4; s. c. 18 Am. Ry. Rep. 565.

[5] See *ante*, chapter on trustees and on parties.

stock, which is granted on the application of the receiver and other trustees.[1]

Two constituent railroad companies of a consolidated company had executed a first and second mortgage. The consolidated company executed a mortgage also. The trustee of the latter proceeded to foreclose. The trustee of the mortgages first named afterward filed bills to foreclose its mortgages, but, upon its assent, the court consolidated its suits with the first filed. In this suit the court ordered the receiver to issue certificates to be used for the purpose of constructing a bridge over a river on the line for the advantage of all, and made them a first lien prior to that of the bondholders. The final decree of the court, declaring this priority of the certificates to be paid out of the proceeds of the sale, was objected to by the trustee of the constituent mortgages. This trustee, having been charged with notice of the original order, and having failed at the time, or at the commencement of its suit, and the extension of the receivership to its suits, to object to the order, and having permitted the receiver to issue the certificates and use them for the purpose proposed, the Circuit Court of Appeals held, was bound by the order, and the decree was sustained.[2]

A trustee of divisional mortgages, who, after the filing of a foreclosure suit by the trustee of a consolidated mortgage, brings suits to foreclose his mortgages, and then has the first suit extended to his; and with full knowledge of the issue of certificates by the receiver under an order of court for the purpose of constructing a bridge, making them a lien prior to the bondholders', fails at any time to object to the order, and allows the receiver to issue and use them, is bound by the order originally authorizing them.[3]

The South Carolina Supreme Court has declared the rule that a court of equity which has placed the property of a railroad company in the hands of a receiver should not grant orders that the receiver issue certificates for the maintenance of the road, making them a lien upon the *corpus* of the property on an *ex*

[1] Vilas *v.* Page (1887), 106 N. Y. 439; Wallace *v.* Loomis (1877), 97 U. S. 146, 162.

[2] Central Trust Co. of New York *et al.* *v.* Marietta & N. Ga. R. Co. *et al.*; Boston Safe Deposit & Trust Co. *v.* Holders of $130,500 of Receiver's Certificates (1896), 75 Fed. Rep. 193.

[3] Boston Safe Deposit Co. *v.* Holders of $130,500 of Receiver's Certificates (1896), 75 Fed. Rep. 193, reaffirmed in Boston Safe Deposit & Trust Co. *v.* Groome *et al.* (1896), 75 Fed. Rep. 209, in which case the certificates were authorized by the court, with a prior lien, for the purpose of purchasing rolling-stock, etc.

parte application of the receiver; that all the parties interested as holders of prior liens should have notice of such application, and be heard upon it.[1]

§ 679. **Dissent of some of the Parties in Interest a Material Circumstance.** — The dissent of some of the parties in interest, though not a conclusive reason for declining to authorize an issue of certificates, will often have great weight with the court, where the circumstances show that the result might be productive of serious injustice to the protestants. Thus an order for such an issue has been refused in a case where it was opposed by the minority of the bondholders, the evidence showing that the road had a merely local business, that it was wrecked and irretrievably insolvent, and that its future was quite problematical even if it should be put in running order, and furnished with an equipment of its own.[2]

Still less will a court, at the instance of a small stockholder, restrain a foreclosure suit and authorize an issue of certificates for the purpose of putting the road in good condition, and thus demonstrating its earning capacity before it is offered for sale, especially where it is apparent that the net earnings would not in any reasonable time suffice to cancel the certificates and at the same time pay the current interest on the bonds.[3]

§ 680. **Consent of Bondholders a Prerequisite to the Issue of First-lien Certificates by a Receiver of a Private Corporation.** — As the essential ground on which the power to issue first-lien cer-

[1] State *v.* Port Royal & A. Ry. Co. *et al.* (S. C., 1895), 23 S. E. Rep. 380.

[2] Investment Co. of Pennsylvania *v.* Ohio & N. W. R. Co. (1888), 36 Fed Rep. 48. The court reasoned as follows: "If the court authorizes certificates to be issued, and made a lien upon the railroad superior to the mortgages, for the purchase and laying of steel rails, for the purchase of equipments, and for the completion of the road, the result may be to cause those things to be done at the expense of and to the detriment of the bond and lien holders, and for the benefit of the purchasers, or of a syndicate holding a majority in amount of the bonds and liens, having peculiar advantages as bidders, and intending to become purchasers at the sale; for it rarely occurs that improvements and betterments add to the salable value of the road anything near their cost." A large majority of the bondholders in this case had filed consents to an order for the issue, but a minority protested. The court said that, if these majority bondholders desired it, an order would be granted authorizing the issue of certificates; that it should not be a charge on the interest, or affect the lien of the minority bondholders. The court doubted whether it was even right, or within the power of a court, against the objection of the mortgagees and others having a large pecuniary interest in a railroad property, to undertake to carry out expensive improvements of this class. There is good ground for holding that such improvements stand on the same footing as actual construction work, which, it is agreed, cannot be authorized, at least on borrowed money, against the will of the secured creditors. (See below.)

[3] Street *v.* Maryland Central Ry. Co. (1893), 59 Fed. Rep. 25.

tificates to keep railroads in operation is that they are public agencies, it follows that this power cannot be exercised in the case of private corporations unless all the parties holding prior liens assent thereto.[1]

Still less will any priority be accorded to certificates issued to creditors of such a corporation for claims arising in the ordinary course of business prior to the receivership.[2]

It has been held in Texas that a waterworks company stands on the same footing as a railroad company in regard to the power of the court to provide for the expenses of a receivership by issuing first-lien certificates;[3] but this case cannot be reconciled with the ruling of the Supreme Court of the United States in Wood *v.* Guarantee Trust & Safe Deposit Co.,[4] where it was held that, so far as the doctrine of back claims was concerned, such a company cannot be treated as a railroad company.

It is not in the power of a court of equity, in a foreclosure suit of a mortgage of the property of any private corporation other than a railroad company, to order an issue of certificates by its receiver for the preservation, etc., of the property, and make them a lien prior to the mortgage, upon either the earnings of the receivership or the *corpus* of the property.[5]

§ 681. **Notice should be given to Parties interested.** — Notice to persons interested should be given before the issue of certificates is authorized, so that they may have an opportunity of disputing the necessity of raising money in this manner.[6]

[1] Farmers' Loan & Trust Co. *v.* Grape Creek Coal Co. (1892), 50 Fed. Rep. 481; Fidelity Insurance, Trust, & Safe Deposit Co. *v.* Roanoke Iron Co. (1895), 68 Fed. Rep. 623.

In Neafie's Appeal (Pa., 1888), 12 Atl. Rep. 271, the receiver of a ship-building company was authorized to continue building some unfinished ships, and, with the consent of all the creditors, was authorized to raise a sum for that purpose on first-lien certificates.

[2] Laughlin *v.* United States Rolling Stock Co. (1894), 64 Fed. Rep. 25; Hooper *v.* Central Trust Co. (1895), 81 Md. 559; s. c. 32 Atl. Rep. 505; Raht *v.* Attrell (1887), 106 N. Y. 423.

[3] Ellis *v.* Vernon Ice, Light, & Water Co. (1895), 86 Tex. 109; s. c. 23 S. W. Rep. 858.

[4] 128 U. S. 416 (1888): s. c. 9 Sup. Ct. Rep. 131.

[5] Hanna *et al.* *v.* State Trust Co. *et al.* (1895), 70 Fed. Rep. 2; s. c. 16 C. C. A. 586, the court referred to Scott *v.* Trust Co. (1895), 69 Fed. Rep. 17.

[6] Union Trust Co. *v.* Illinois Midland Ry. Co. (1887), 117 U. S. 434, 455; s. c. 25 Am. & Eng. R. R. Cas. 560; Dorn & McKee, Trustees, *v.* Crank (1892), 96 Cal. 383; *Ex parte* Mitchell (1879), 12 S. C. 83.

Debenture-holders do not represent other debenture-holders. Securities Co. *v.* Brighton Alhambra (1893), 68 L. T. (Ch.) 249. See also *In re* Regent's Canal Co. (1876), 3 Ch. D. 421, per James, L. J.; *In re* Ormerod, Grierson, & Co., W. N., Dec. 13, 1890, p. 217, per Stirling, J.

Circumstances may be judicially equivalent to notice; as where those who will be affected by the issue have had their day in court, and been heard, on evidence, as to the propriety of the expenditures proposed, and of making them a first lien on the property.[1]

Unless prior notice is given to the parties interested, both the receiver and those lending money on the certificates take the risk of such final action as the court may take in regard to the loans.[2]

A bondholder cannot complain that certificates were issued without due notice to the class of lienors to which he belongs, where the trustees of the mortgage securing his bonds were parties to the suit, and, having due notice of the application, made no objection to its being granted.[3]

§ 682. **The Necessity for the Issue must be clearly established.** — The necessity for the issue of the certificates must be clearly established, and to that end the court should not authorize such a step, unless a detailed statement is first made out, specifying the items of the sum needed and the purposes to which it is to be applied, and satisfactory evidence is offered, after proper

[1] Union Trust Co. *v.* Illinois Midland Ry. Co. (1887), 117 U. S. 434, 455; s. c. 25 Am. & Eng. R. R. Cas. 560.

[2] Union Trust Co. *v.* Illinois Midland R. Co. (1887), 117 U. S. 434, 455; s. c. 25 Am. & Eng. R. R. Cas. 560; Hervey *v.* Illinois Midland R. Co. (1886), 28 Fed. Rep. 169, 176. In the latter case Mr. Justice Harlan said: "The holder of certificates issued by a receiver, under authority of the court to borrow money and give certificates therefor, for the protection of the trust property, must be deemed to have taken them subject to the rights of parties who have prior liens upon the property, and who have not, but should have, been brought before the court; and where such prior lienholders are brought before the court, they are entitled to contest the necessity, validity, effect, and amount of such certificates, the same as if such questions were then first presented, and the court will then declare such certificates to be superior or subordinate to such prior liens as equity may require. If it appears that they ought not to have been made a charge upon the property superior to the lien created by the mortgagees, then the contract rights of the prior lienholders must be protected. On the other hand, if it appears that the court did what ought to have been done, even had the trustee and the bondholders been before it at the time the certificates were authorized to be issued, the property should not be relieved from the charge made upon it for its protection and preservation. Of these rules or principles the parties (judgment creditors) who inaugurated this litigation cannot fully complain. They were not ignorant of the fact that there were existing mortgages upon this property, and that fact should have been brought to the attention of the court at the very outset. Nor have the bondholders any ground of complaint if the court charges upon the property such expenditures as now appear to have been rightfully made in the interest of all concerned in its management while in the hands of a receiver."

[3] Wallace *v.* Loomis (1877), 97 U. S. 146; Hoover *v.* Montclair & Greenwood Lake Ry. Co. (1878), 29 N. J. Eq. 4; s. c. 18 Am. Ry. Rep. 565. As to the representative position of the trustee in litigation affecting the bonds, see Chap. XXIV., *ante* (parties).

notice to the parties interested, that the statement is correct, and that it is indispensable for the preservation of the estate to raise the money.[1]

A receiver will not be authorized to borrow money for the equipment of the road by creating a car trust, when the only purpose of effecting the loan is to set the earnings free for application to the bonded interest. Such a course would be inconsistent with the essentially temporary character of the administration of the property, as well as with the principle that such loans are justified only by the necessity of providing funds for the operation of the road.[2]

ARTICLE IV. — PURPOSES FOR WHICH FIRST-LIEN CERTIFICATES MAY BE ISSUED DURING A RECEIVERSHIP.

§ 683. **Funds required to keep the Road in Operation may be procured by Issue of First-lien Certificates.** — Whatever funds are required to keep up the business as a going concern may, as a necessary consequence of the principles stated above, be procured by issuing first-lien certificates for the purpose of putting the road in repair, and operating it, for the purchase of rolling-stock or other equipment, and for the payment of claims for labor and rental.[3]

Where the mineral property of a mining company has no marketable value without a railroad operated in connection therewith, the proceeds of first-lien certificates may be used in rebuilding a bridge to restore communications between the two properties, and in acquiring by condemnation proceedings a perfect title to a portion of the road-bed.[4]

§ 684. **Issue of Certificates to pay Taxes.** — The lien for taxes being superior to all other liens whatsoever, except judicial costs, certificates issued to pay such a lien are accorded a corresponding priority.[5]

[1] Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467. See Securities, etc. Co. *v.* Brighton Alhambra, Lim. (1893), 68 L. T. (Ch.) 249.

[2] Taylor *v.* Philadelphia & Reading R. Co. (1881), 14 Phil. 501; s. c. 9 Fed. Rep. 1; 3 Am. & Eng. R. R. Cas. 177.

[3] Wabash, St. Louis, & Pac. R. Co. *v.* Central Trust Co. (1884), 22 Fed. Rep. 269, 271; Wallace *v.* Loomis (1877), 97 U. S. 146; Miltenberger *v.* Logansport Ry. Co. (1884), 106 U. S. 286; s. c. 12 Am. & Eng. R. R. Cas. 464; Union Trust Co. *v.* Illinois Midland Ry. Co. (1887), 117 U. S. 434; s. c. 25 Am. & Eng. R. R. Cas. 560; Vilas *v.* Page (1887), 106 N. Y. 439; Kneeland *v.* American Loan & Trust Co. (1890), 136 U. S. 89; Kneeland *v.* Bass Foundry, etc. Works (1891), 140 U. S. 592.

[4] Karn *v.* Rorer Iron Co. (1890), 86 Va. 754; s. c. 11 S. E. Rep. 431.

[5] Union Trust Co. *v.* Illinois Midland R. Co. (1887), 117 U. S. 434; s. c. 25 Am.

Taxes being the first and paramount lien on all property where the property of a corporation of any kind is in the hands of a receiver, the court will authorize him, if he has no funds in his hands for the purpose, to borrow money to pay the taxes, and, whatever the obligation given by the receiver, whether certificates or otherwise, for the borrowed money it will be a prior lien on the property on which the taxes were due.[1]

§ 685. **Issue of Certificates to pay Back Claims for Labor, Supplies, &c.** — To justify making receiver's certificates for the payments of back claims a first lien on the *corpus* of the property, it must appear either that (1) there has been a diversion of the earnings to the prejudice of the claimants,[2] or (2) that it is absolutely necessary for the conservation of the property to raise money in this way. In the latter case, back claims will come within the principle which justifies the issue of first-lien certificates to meet the charges which accrue after the commencement of the receivership.[3]

The mere fact that the value of the mortgage lien has been enhanced by the labor of a claimant is not a sufficient reason for displacing that lien in his favor. If this argument were allowed to prevail, it is obvious that the foreclosure of a mortgage might in many instances be rendered inoperative and useless.[4]

& Eng. R. R. Cas. 560. This was one ground for issue of certificates in Murrietta *v.* The Nevada Land & Cattle Co., Lim. (1892), 93 Law Times, 442.

[1] Hanna *et al.* *v.* State Trust Co. *et al.* (1895), 70 Fed. Rep. 29. See Dummer *v.* Lindley *et al.* (Mich., 1896), 68 N. W. Rep. 260, 264.

[2] Street *v.* Maryland Central R. Co. (1893), 59 Fed. Rep. 25; Union Trust Co. *v.* Illinois Midland Ry. Co. (1887), 117 U. S. 434; s. c. 25 Am. & Eng. R. R. Cas. 560; St. Paul Title Ins. & Trust Co. *et al.* *v.* Diagonal Coal Co. *et al.* (Gunson *et al.*, Interveners), (Iowa, 1896), 64 N. W. Rep. 606, where the order appointing a receiver in the foreclosure suit provided for the borrowing of money by the receiver for the payment of wages, etc., due laborers for the ninety days prior to the receivership, and making the obligation given for the loan a preferred lien upon the *corpus* of the property.

As to what class of claims for the payment of which a court may order a receiver to issue certificates with a lien prior to the mortgage or trust deed, see Ames *et al.* *v.* Union Pac. Ry. Co. *et al.* (1896), 74 Fed. Rep. 335, 345.

[3] Miltenberger *v.* Logansport Ry. Co. (1884), 106 U. S. 286; s. c. 12 Am. & Eng. R. R. Cas. 464. For an extract from the opinion in this case, showing the circumstances under which the doctrine stated in the text was applied, see Chap. XXVII., (preferential debts).

[4] Metropolitan Trust Co. *v.* Tonawanda Valley & Cuba R. Co. (1886), 103 N. Y. 245; s. c. 8 N. E. Rep. 488. The court said: " No case has been cited where an unsecured creditor, however meritorious the consideration of his claim, has been given a priority over a lien contracted for and in force when his debt was created. When, as in this case, the plaintiff procures the appointment of a receiver, with power to control and operate the mortgaged railroad, he cannot well object to the depreciation of his security by expenses incurred for those purposes, but he may

But as the fund available for the payment of "back claims" which are allowed a priority is produced by the administration of the court, it may be distributed, at the discretion of the court, in such a manner as not to embarrass the receivers; and these claims may therefore be paid by certificates, bearing interest and payable out of any funds applicable thereto, at such dates as may afterwards be fixed by the receivers.[1]

The income on which certificates issued for the payment of back claims is chargeable is, of course, the net income after the payment of the expenses of the receivership, and there are obvious practical difficulties in the way of anticipating such earnings. Some agreement between the parties would seem to be absolutely necessary in order to procure money in this manner, if it is desired to give immediate relief to the creditors.[2]

§ 686. **Issue of Certificates to keep up Single Divisions of a Consolidated System.** — The same considerations which point to the propriety of keeping a single road in operation by the issue of certificates are applicable to cases where the property consists of several divisions. If any of those divisions are operated at

properly seek to have excluded any previous one." In view of the two cases cited above, this sweeping statement must evidently be taken with some qualification. The court also referred to some New York statutes relied on by the claimant. By the laws of 1850, ch. 140, § 10, and of 1854,, ch. 282, § 16, a laborer was given a remedy in certain cases against the stockholders upon default of the corporation to meet its obligations. This, it was pointed out, could not justify a decree which required the payment of such a creditor out of the property of other creditors. By the act of 1885, ch. 376, the receiver of an insolvent corporation was required to pay the wages of employees in preference to the other debts. It was doubted whether this statute was applicable to foreclosure proceedings, but it was held that, as it had not been enacted when the proceedings were instituted, it could not be invoked to sustain the decree appealed from.

[1] Taylor *v.* Philadelphia & Reading R. Co. (1881), 7 Fed. Rep. 377. In Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1885), 23 Fed. Rep. 863, it was mentioned that an issue of certificates was authorized at the inception of the receivership to procure funds to pay back claims, but no more than about one-sixth of the number authorized were sold, as the earnings were found to be sufficient to discharge the debts. Compare Gurney *v.* Atlantic & Great Western R. Co. (1874), 58 N. Y. 358; Atkins *v.* Petersburg R. Co. (1879), 3 Hughes, 307. In this last case the certificates were issued to repay the advances of one who had lent money to avert an impending strike. The circumstances were, therefore, virtually the same as in Miltenberger *v.* Logansport Ry. Co., *supra,* and under the doctrine of that case it would seem that the certificates might have been declared a lien on the *corpus,* unless the fact that the proceeds were not paid directly to the creditors whose conduct threatened the safety of the road may be thought to make a difference. The court, however, went no further than to declare that the certificates might be made a lien on the income.

[2] See Street *v.* Maryland Central Ry. Co. (1893), 59 Fed. Rep. 25.

a loss, the deficiency should be paid out of the earnings of the entire system, supplemented, if need be, by the proceeds of certificates chargeable on the whole trust fund.[1]

§ 687. **Issue of Certificates to pay for Construction Work generally.** — Since the functions of a court which is administering a road through a receiver are essentially preservative in their nature, it is clear that the construction of additional lines is, strictly speaking, beyond the scope of its powers.[2]

A road "should be kept in proper condition, not only for the current business during the receivership, but for continuing to do it, without the necessity for special and extraordinary outlay on passing back to the possession and use of the owners. But for any legitimate purpose a receivership cannot be extended to the controlling and maintaining, and repairing and equipping, other roads, or to the building or buying of other roads, or to the control and operating of lines of steamboats, or steamboats in the lines of other roads, even with the view of larger earnings, and larger net income of the property which is the subject of the receivership. It is fundamental in the law that a receivership is temporary, — to serve an existing exigency of a temporary nature, and when that is done, to cease."[3]

A court is reluctant to apply even the current income to the construction of new lines;[4] though it does not now admit of question that the earnings will even be anticipated by the issue of certificates, for the purpose of procuring funds to construct unfinished portions of the line, where there is a reasonable prospect that the resulting increase of business will soon reimburse all moneys expended.[5]

[1] Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1885), 23 Fed. Rep. 866.

[2] Clap *v.* Interstate St. R. Co. (1894), 61 Fed. Rep. 537. The ground was here taken that it was not the business of a court to build railroads, or to set railroads in operation which have ceased to run, but merely to continue the operation of the roads of which it may take charge wherever it is practicable, and, there being no proof of a request from the parties in interest, an application from the receiver for authority to expend a large sum of money to rebuild the power-house of one of the branches of a street railway was refused.

[3] Vermont & Canada R. Co. *v.* Vermont Central R. Co. (1877), 50 Vt. 500; s. c. 14 Am. Ry. Rep. 497.

[4] In Gilbert *v.* Washington City, Va. Midl. & Grt. Southern R. Co. (1880), 33 Gratt. (Va.) 586; s. c. 1 Am. & Eng. R. R. Cas. 473, the lower court had authorized the construction of a short branch to connect with another road. The appellate court waived the question as to the right to make such an expenditure, but said that it was too late to make any objection after two years had been allowed to pass without raising any objection, especially as the pecuniary result of the court's action had been eminently beneficial.

[5] Miltenberger *v.* Logansport R. Co. (1884), 106 U. S. 286; s. c. 12 Am. & Eng. R. R. Cas. 464.

The objections to a court's engaging in construction work are much stronger where the necessary funds can be procured only by borrowing on first-lien certificates. Yet it is now the established doctrine that exceptional circumstances may arise which will justify a court in taking even this extreme step. Being an extraordinary exercise of power, this displacement of earlier liens is admitted to be permissible only in cases of the most urgent necessity. Such a necessity, it is held, is presented when the building of an additional line or lines is requisite to give the mortgagees the full benefit of their security. Thus where a conditional land-grant covered by the mortgage is in danger of being forfeited because the embarrassed condition of the company prevents it from finishing the road within the period fixed by the legislature, it is not improper to appoint a receiver with power to raise such money as may be requisite, and to make the loan a paramount lien on the estate.[1]

So it has been held that where, under the provisions of certain acts of Congress, lands covered by the mortgage of a canal company were to revest in the United States unless the canal was finished within a given time, the court might legitimately authorize a receiver of the property to raise money to complete the work by issuing first-lien certificates.[2]

[1] Allen *v.* Dallas & Wichita R. Co. (1878), 3 Woods, 316; Kennedy *v.* St. Paul & Pacific R. Co., 5 Dill. 519. At p. 525 of the opinion in the last case, Judge Dillon said: "I assent in the fullest manner to the proposition that a court of equity ought not to enter upon the work of either operating or building a railroad, if this can possibly be avoided without the certain and great sacrifice of the rights and securities of the parties in interest. The original order in this case was made upon this principle, and upon the exceptional case which the road presented. It is not to be inferred from the report of that case that authority even to complete the building of an unfinished line of railway, and to issue debentures for that purpose, is to be conferred without an overwhelming necessity. When such authority is conferred, it ought to be guarded with the utmost care." Afterwards, in this same matter, as the railroad company had a franchise to build a bridge across the Mississippi River which was not included in the mortgage, the court allowed the bondholder complainants and the receiver to be made parties to an application to permit outside parties to build this bridge, and approved a contract for its construction and use, subject to certain conditions limiting the duration of the contract, and regulating the compensation to be paid for the use of the bridge by the railroad company, or its assigns, or successors, or the purchasers at the foreclosure sale. In the matter of La Crosse Railroad Bridge (1873), 2 Dill. 465.

In Kropholler *v.* St. Paul, Minneapolis, & Manitoba Ry. Co. (1880), 2 Fed. Rep. 302, the propriety of an order authorizing a receiver to issue debentures for the completion of the road was under review. The power of the court to make such an issue was not questioned, the point ruled being that the complaining bondholder had no ground for equitable relief on the ground that the issue had been excessive.

[2] Jerome *v.* McCarter, 94 U. S. 734.

A loan secured by first-lien certificates has also been authorized in a case where some inconsiderable portions of the road remained so far unfinished as to be unsafe for the passage of trains.[1]

§ 688. **Certificates to pay for Construction Work cannot be made a First Lien on the Road without the Consent of Prior Lienors.** — The court has, in any event, no power to charge a loan for construction purposes as a first lien on the property, unless the parties secured by earlier liens consent to have their claims postponed in this manner. This rule receives negative support from the cases cited in the foregoing section, as the application for leave to borrow money was made with the concurrence of the mortgagees in every instance in which a loan was authorized, and has been announced in direct terms in a well-known Alabama case.[2] The trial court undertook to issue first-lien certificates without the consent of the mortgagee, and the appellate court ruled that in doing so he had passed the bounds of his jurisdiction. A railroad company, it was pointed out, the fruits of whose labor and expenditures are about to be lost by the failure of its enterprise, cannot, in order to raise money to complete it, create liens on its property which will displace older liens, and the power of a court of equity which is managing the property is equally limited. The court said: "If the action of a chancellor in this cause goes to the extent of taking the property of the defendant, for the purpose, through his appointees, of completing an unfinished work, or of enlarging or improving a finished one, *beyond what is necessary for its preservation*, and, to that end, of raising money by charging the railroad and its appurtenances with liens which are to supersede older ones, without the consent of the holders of these, he has inadvertently passed beyond the bounds of a chancellor's jurisdiction."

In Hale *v.* Nashua & Lowell Railroad (1880), 60 N. H. 333, it is not apparent from the report whether the consent of the secured creditors was obtained before ordering the completion of the road by a receiver; but if the cases are intended to go to that extent, it is opposed to the current of authority.

In other courts the ground has been taken that it is not only no part of the duty of a court to build railroads, but also that

[1] Stanton *v.* Alabama & Chattanooga R. Co. (1875), 2 Woods, 506.

[2] In Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467.

even the assent of all the parties interested cannot make it such.[1]

Where this view is taken, no difference will be made between building a railroad and making extensive repairs and betterments, the cost of which is sometimes nearly as great as that of the original construction.[2]

The Supreme Court of the United States has taken a middle ground, and, while conceding that the power of a court may, under extraordinary circumstances, be used to enable mortgagees to protect their securities by borrowing money to complete unfinished roads, expressed its opinion that it is always better in such emergencies to reorganize the company on the basis of existing mortgages as stock, or something which is equivalent, and by a new mortgage with a lien superior to the old raise the money which is required. The result of this plan, so far as incumbering the mortgage security is concerned, is the same substantially as if first-lien certificates are issued, while the reorganization places the whole enterprise in the hands of those immediately interested in its prosecution.[3]

ARTICLE V. — RIGHTS OF THE HOLDERS OF A RECEIVER'S CERTIFICATES.

§ 689. **Receiver's Certificates not Negotiable Instruments.** — That receiver's certificates are not negotiable instruments is well settled.[4]

They do not fulfil the conditions requisite to give written instruments for the payment of money the character of negotiability by indorsement, viz., that they shall be payable absolutely and at all events, independently of any contingency either in regard to the event or the fund out of which payment is to be

[1] Paine *v.* Little Rock Ry. Co. (Circuit Ct. E. D. Arkansas, 1874), per Caldwell, J., who declined to follow Stanton *v.* Alabama R. Co. and Kennedy *v.* St. Paul R. Co., *supra*, and adopted the alternative course of expediting the foreclosure proceedings and rendering a decree fitted to meet the exigencies of the case. This the Supreme Court of the United States declared to be a much more desirable plan than to issue certificates. (See below.)

[2] Ibid.

[3] Shaw *v.* Railroad Company (1879), 100 U. S. 605. In this case, also, a land grant was imperilled by the non-completion of the road.

[4] Union Trust Co. *v.* Illinois Midland R. Co. (1887), 117 U. S. 434, 455; s. c. 25 Am. & Eng. R. R. Cas. 560; Stanton *v.* Alabama & Chattanooga R. Co. (1875), 2 Woods, 506; s. c. 31 Fed. Rep. 585 (1887); Swann *v.* Clark (1884), 110 U. S. 602; Union Trust Co. *v.* Chicago & Lake Huron R. Co. (1880), 7 Fed. Rep. 513; Bank of Montreal *v.* Chicago, C. & W. R. Co. (1878), 48 Iowa, 518.

made, or as to the parties by whom or to whom payment is to be made.[1]

The most that can be said of them is that they are evidence in the hands of the holder that he is entitled to receive from the fund under the control of the court which authorized its officer to issue them the amount specified, if the fund is sufficient to pay in full all holders of such certificates, or if it is not sufficient, then only a *pro rata* share with other holders.[2]

The mere fact that by their terms they inure to the benefit of the "bearer" does not impart to them the quality of commercial paper. The use of that word imports assignability, not negotiability, and, even if it is omitted, they are still capable of transfer.[3]

§ 690. **Purchasers affected with Notice of all Circumstances attending the Issue of the Certificates.** — Any one who purchases certificates is bound to ascertain whether they were issued in accordance with the terms and contingencies contemplated in the order by virtue of which they were issued,[4] and is charged with notice of all that has been done during the pendency of the litigation up to the date of his purchase, as well as of all subsequent proceedings therein, and that by the final action of the court the validity or security of the instruments may be prejudicially affected.[5]

If disposed of in a manner and for a purpose not authorized by the order under which they were issued, receivers' certificates are invalid and of no effect as against the property,[6] whether in the hands of the original holder or of a subsequent purchaser or pledgee. Thus if one of the set of certificates authorized for the purpose of paying off an indebtedness contracted by a former receiver is issued to a payee who has no claim on the trust fund, his transferee will stand in no better position than himself in the court where the fund is being administered.[7]

[1] Turner *v.* Peoria & Springfield R. Co. (1880), 95 Ill. 134; s. c. 1 Am. & Eng. R. R. Cas. 348.

[2] Ibid.

[3] Railroad Co. *v.* Howard (1868), 7 Wall. 392; Turner *v.* Peoria & Springfield R. Co. (1880), 95 Ill. 134; s. c. 1 Am. & Eng. R. R. Cas. 348. This latter case was considered both with reference to the common-law rules regarding instruments for the payment of money, and also with reference to the Illinois statute on the subject. The same conclusion was held to be proper, from whichever point of view the rights of the parties were examined.

[4] Bank of Montreal *v.* Chicago, C. & W. R. Co. (1878), 48 Iowa, 518.

[5] Mercantile Trust Co. *v.* Kanawha & Ohio Ry. Co. (C. C. A., 1893), 58 Fed. Rep. 6.

[6] Stanton *v.* Alabama & Chattanooga R. Co. (1887), 31 Fed. Rep. 585.

[7] Turner *v.* Peoria & Springfield R. Co. (1880), 95 Ill. 134; s. c. 1 Am. & Eng. R. R. Cas. 348.

Authority to issue certificates "for money borrowed, *material furnished*, *labor* performed, or on account of contracts made by him for or on account of the construction or completion of said road or any part thereof," does not empower the receiver to issue such certificates for material which is merely contracted to be delivered, even though the order of appointment also contains a general authority to "do and perform all the acts and things necessary to be done and performed to construct said line of railroad."[1]

Certificates issued in excess of the number authorized in the order of the court are absolutely void.[2]

The rule that the certificate-holder is not bound to look behind the order which authorized the issuance may also inure to his benefit. Thus where the order does not limit the payment to any particular fund, any such limit apparent on the face of the certificates is of no force or consequence, because they are the mere forms by which the order of the court is executed.[3]

§ 691. **Rank of Certificates depends on Final Decree.** — That the holders of receivers' certificates depend for their ultimate rank upon the final decree in the cause in which the certificates are issued is well settled.[4]

The interest of the holder of such instruments is acquired not merely subject to all the restrictions imposed by the doctrine of *lis pendens*, but by virtue of the litigation. By the very act of purchasing the certificates he is put upon inquiry as to all that has been done in the course of the litigation, and is charged with notice of all the subsequent proceedings therein as if he had been an actual party to the record.[5] For example, holders of certificates issued subsequent to decrees sustaining a mechanic's lien, and directing a sale of the property subject to that lien, are privies to such decree and take subject to the lien.[6]

But the lien of the certificates continues as long as the order authorizing their issuance remains in force. The fact that a referee is appointed to determine all claims against the receivership, and a report of his has been confirmed which makes no allusion to the certificates, in not an adjudication against them,

[1] Bank of Montreal *v.* Chicago, C. & W. R. Co. (1878), 48 Iowa, 518.

[2] Newbold *v.* Peoria & Springfield R. Co. (1879), 5 Ill. App. 367.

[3] Neafie's Appeal (1888), 12 Atl. Rep. 271.

[4] Union Trust Co. *v.* Illinois Midland Ry. Co. (1887), 117 U. S. 434.

[5] Mercantile Trust Co. *v.* Kanawha & Ohio Ry. Co. (1893), 58 Fed. Rep. 6, 11.

[6] Gordon *v.* Newman (1894), 62 Fed. Rep. 686 ; s. c. 10 C. C. A. 587.

when it appears that they were not presented or considered, and that the holder had no notice of the reference.[1]

§ 692. **Negotiation and Sale of Certificates a Trust personal to Receiver.** — The negotiation and sale of receiver's certificates being a trust personal to the receiver himself, the rights of one who purchases them from any person other than the receiver himself must be determined on the assumption that the seller is himself a holder, and not an agent of the receiver. The purchaser, even though he has paid a valuable consideration for the certificates, and is without notice of any facts bearing on their validity, except such as appear in the order of the court, takes them, under such circumstances, subject to all the equities between the original parties. If, therefore, his assignor, though actually intrusted with the certificates by the receiver for the purpose of negotiation and sale, fails to account with the receiver for the proceeds, the purchaser does not stand in a position to charge the fund of the receivership with the payment of the certificates. Especially is this the case when he is able to effect the purchase at a very large discount very soon after the certificates are issued, this being sufficient to put him on inquiry as to the existence of some infirmity.[2]

§ 693. **The Trust Fund is not liable for the Payment of a Receiver's Certificates unless the Proceeds come under his Actual Control.** — This rule is sufficiently complied with where the proceeds are deposited to his credit in a bank in the form of checks, drafts, etc., which are afterwards duly honored by the drawers. The validity of the certificates, in such a case, is not impaired by the fact that the bank has never, at any time after such deposit was made, been in a condition to pay over any considerable portion of the deposit.[3]

§ 694. **Purchasers of Certificates not bound to see to Application of Proceeds.** — Persons having no connection with the case or the parties, who take certificates directly from the receiver, are not bound to see that the proceeds are properly applied.[4]

§ 695. **Rights of Purchasers not affected by taking Collateral Security.** — Purchasers of receiver's certificates do not, by taking a special collateral security, make that the only security upon

[1] Mercantile Trust Co. *v.* Kanawha, etc. Ry. Co. (1892), 50 Fed. Rep. 874.

[2] Union Trust Co. *v.* Chicago & Lake Huron R. Co. (1881), 7 Fed. Rep. 513.

[3] Ala. Iron & Ry. Co. *v.* Anniston Loan & Trust Co. (1893), 57 Fed. Rep. 25.

[4] Union Trust Co. *v.* Illinois Midland Ry. Co. (1887), 117 U. S. 434; s. c. 25 Am. & Eng. R. R. Cas. 560; s. p. Stanton *v.* Alabama & Chattanooga R. Co. (1875), 2 Woods, 506.

which they have a right to rely to enforce the payment of the certificates.[1]

§ 696. **Bondholders, when estopped to dispute Validity of Certificates.** — A bondholder who, with a full knowledge of all the circumstances and conditions under which certificates were issued, lies by and permits others in good faith to invest their money in receiver's certificates, cannot afterwards be heard to assert that such certificates are not a lien on the property superior to the mortgage.[2]

Similarly, when the bondholders suffer certain persons to appear to the world in the character of receivers, and, as such, to issue negotiable obligations, the rights of the purchasers of those obligations are the same whether they are strict receivers or not. To such a case the principle is applicable that, where one of two innocent parties must suffer by the act of a third, he who gave the power or opportunity to do the act must bear the burden of the consequences.[3]

§ 697. **Receiver, when estopped to dispute Validity of Certificates.** — As against an innocent purchaser of certificates, a receiver cannot be heard to dispute their validity where he authorized the president of a bank, in which he keeps his deposits, to sell them, and afterwards drew checks against the amount credited to him for the proceeds of the sale, and reported the transaction to the court. Under such circumstances it is immaterial that the authority of the president of the bank to sell the certificates was revoked before the sale in question was made; and the fact that the receiver, upon learning that the bank was insolvent, obtained from the president certain collateral securities to protect his deposits, will be regarded not as a repudiation, but rather as an additional ratification, of the sale of the certificates.[4]

A merely personal contract, whereby the purchaser of a railroad agrees to pay off certain certificates which are invalid because of the manner in which they were issued, is ineffectual to

[1] Langdon *v.* Vermont & Canada R. Co. (1880), 53 Vt. 228; s. c. 4 Am. & Eng. R. R. Cas. 33.

[2] Humphreys *v.* Allen (1882), 101 Ill. 490; s. c. 4 Am. & Eng. R. R. Cas. 14.

[3] Langdon *v.* Vermont & Canada R. Co. (1880), 53 Vt. 228; s. c. 4 Am. & Eng. R. R. Cas. 33. In this case the receivers originally appointed continued to act as such after the property had passed under the control of the bondholders, their authority being derived from various decrees and orders entered by consent of the parties. The case, therefore, is a very special one, the rights of the purchasers being determined by the principle of the estoppel.

[4] Ala. Iron & Ry. Co. *v.* Anniston Loan & Trust Co. (1893), 57 Fed. Rep. 25.

charge the property in the hands of such purchaser when he afterwards becomes receiver.[1]

§ 698. **Court, when bound to recognize the Estoppel of Receiver to dispute Validity of Certificates.** — Where the receiver recognizes the validity of a sale of certificates by accepting a credit at a bank for the amount of the proceeds, and afterwards drawing against the deposit, the court will consider itself bound by the estoppel thus raised against its agent, and treat the certificates as a valid lien upon the trust fund as against the purchasers at the foreclosure sale. Especially will such protection be extended to innocent holders of the certificates, if the purchase of the railroad was made with full knowledge that the certificates were outstanding, and the purchasers have taken an assignment of certain securities which the receiver had obtained from the bank to protect his deposits, and which, at the same time they were given, were considered amply sufficient for that purpose.[2]

§ 699. **Amount recoverable by Holders of Receiver's Certificates.** — The purchasers of certificates taken within the limit of the discount allowed by the court in the order authorizing their issue are entitled to the face value of the certificates.[3]

Those who pay for them less than the lowest percentage of the par value for which they may be disposed of can be credited only with the sum actually paid.[4]

§ 700. **Usury Laws applicable only to Receiver's Certificates.** — The Chancellor has no power to disregard the laws against usury, by authorizing a receiver to borrow money by the sale of interest-bearing certificates at less than their face value.[5]

§ 701. **Holders need not present the Certificates for Payment before Foreclosure Sale.** — A holder of certificates is not guilty of laches in failing to present them for payment before the foreclosure sale. They are practically call loans, and he has a right to assume that the receiver will notify him when the loan is to be called or the money paid.[6]

[1] Stanton *v.* Alabama & Chattanooga R. Co. (1887), 31 Fed. Rep. 585.

[2] Ala. Iron & Ry. Co. *v.* Anniston Loan & Trust Co. (1893), 57 Fed. Rep. 25.

[3] Union Trust Co. *v.* Illinois Midland R. Co. (1887), 117 U. S. 434; s. c. 25 Am. & Eng. R. R. Cas. 560.

[4] Stanton *v.* Alabama & Chattanooga R. Co. (1875), 2 Woods, 506; Swann *v.* Clark (1884), 110 U. S. 602. In the former case the order prescribed that the certificates should not be sold for less than ninety cents on the dollar. They were hypothecated by the receivers to secure advances, the sum so received being less than ninety per cent of their face value. The court allowed the pledgees to retain only so many certificates as, rating them at ninety cents on the dollar, represented the amount advanced, and ordered the rest to be returned to the receiver.

[5] Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467.

[6] Mercantile Trust Co. *v.* Kanawha & Ohio Ry. Co. (1892), 50 Fed. Rep. 874.

CHAPTER XXXI.

LIABILITIES OF COMPANY AND RECEIVER DURING RECEIVERSHIP.

ARTICLE I. — LIABILITIES OF COMPANY DURING RECEIVERSHIP.

As to the enforcement of liabilities of receiver, see Chap. XXIX., *ante*.

§ 702. **Contract Liabilities of Company suspended by Appointment of Receiver.** — Contractual obligations of the mortgagor company arising out of the management of the mortgaged property, terminate when it loses power to control the property.[1]

But the existence of the corporation is not interfered with, nor its officers displaced, by an order which constitutes the directors in effect receivers of the corporate property, especially when the corporation continues to carry on its business as before, and elects its officers at regular periods. A note for current debts,

[1] Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush (Ky.), 673; s. c. 18 Am. Ry. Rep. 221.

given by the corporation, while such an order remains in force, and signed by the president and treasurer as such, will, therefore, be treated as having been made and taken without any reference to the fund of the *quasi* receivership.[1]

§ 703. **Company's Liability in Tort ceases after Receiver assumes Control.** — "Where a court of proper jurisdiction seizes a railroad, takes it from the custody and control of its corporate officers, and puts the same into the hands of a receiver to be operated under the directions of the court, such receiver is the governing power operating the road, and is alone liable for wrongs and injuries committed by himself or his servants."[2]

A railway company, in the absence of a statute imposing liability, is not answerable for injuries resulting from the mistakes or negligence of a receiver or his agents while operating a railroad.[3]

A railroad company will be held liable for the acts of a receiver where the property is returned to the company without sale, after a large expenditure by the receiver of current revenues in betterments, etc.[4]

Since injuries caused by the misconduct of the employees of a receiver are done while the railroad company is out of the possession of the property, and has no control over it, no liability attaches to the company on account of those injuries.[5]

[1] *Ex parte* Williams (1881), 17 S. C. 396; s. c. 12 Am. & Eng. R. R. Cas. 425.

[2] Ricks, D. J., in Chamberlain *v.* New York, Lake Erie, & Western R. Co. (1895), 71 Fed. Rep. 636. See Meara's Admr. *v.* Holbrook, 20 Ohio St. 137.

[3] Schurr *v.* Omaha & St. Louis Ry. Co. (Iowa, 1896), 67 N. W. Rep. 280. See Godfrey *v.* Railway Company, 116 Ind. 30; s. c. 18 N. E. Rep. 61; State *v.* Wabash Ry. Co., 115 Ind. 406; s. c. 17 N. E. Rep. 909; Metz *v.* Railroad Company, 58 N. Y. 66; Railroad Company *v.* Stringfellow, 44 Ark. 322; Railroad Company *v.* Donough, 72 Tex. 111; s. c. 10 S. W. Rep. 711; Murphy *v.* Holbrook, 20 Ohio St. 145; Thurman *v.* Railroad Company, 56 Ga. 376; Brockert *v.* Railway Company, 82 Iowa, 370; s. c. 47 N. W. Rep. 1026.

[4] Texas & Pac. Ry. Co. Watson *et al.* (Tex. Civ. App., 1896), 36 S. W. Rep., 290; Henderson *v.* Walker (1875), 55 Ga. 481; Thurman *v.* Railroad Co. (1876), 56 Ga. 376, reaffirmed and adhered to in Youngblood *v.* Comer (Ga., 1895), 23 S. E. Rep. 509, and Patterson *v.* Central Railroad & Bkg. Co. *et al.* (Ga., 1895), 23 S. E. Rep. 509; Brown *v.* Comer *et al.* (Ga., 1896), 25 S. E. Rep. 176.

[5] Davis *v.* Duncan (1884), 19 Fed. Rep. 477, 481; Roger *v.* Mobile & Ohio R. Co. (Tenn., 1882), 12 Am. & Eng. R. R. Cas. 442; Memphis & C. R. Co. *v.* Hoechnet (C. C. A., 1895), 67 Fed. Rep. 456; Metz *v.* Buffalo, Corry, & Pittsburgh R. Co. (1874), 58 N. Y. 61. In the latter case the court said: "In reference to the position that the receiver and assignee was the agent and servant of the defendant, which were therefore liable for his acts, it must be borne in mind that the defendant was not a voluntary bankrupt. The appointment of Barrey as receiver was by the court, against its will. It had nothing to do with his appointment, or any control over his employees. Upon what principle can the defendant be held responsible for their negligence? A master or employer is held liable for the negligence of those

This rule is not affected by the fact that the president of the company is the receiver.[1]

But if a road is partly in the hands of a receiver and partly operated by a lessee, and the company allows passenger tickets to be issued in its name, it will be liable to a passenger for damages resulting from the acts of employees engaged in operating the road. In this case the road is run on the joint account of the lessees and the receiver, and the servants are controlled by them jointly, and not by the receiver alone.[2]

It has also been held, in a recent case, that a receiver appointed by a court which has no jurisdiction over the territory in which the property is situated, or in proceedings instituted by the parties collusively, in order to accomplish a purpose unlawful in itself, must be considered as the agent of the company, which is therefore liable for injuries resulting from the operation of the road by him.[3]

But a railroad company is not relieved from responsibility for injuries caused by the operation of the road, unless the possession of the receiver is exclusive. Thus where the only substantial duty discharged by the receiver is to receive the net earnings of the road, and to account therefor to the court, and upon his appointment he continues to employ the same officials in their former positions, and the business of the road, so far as is known to the public, is conducted upon the same footing as before up to the time of the accident, a verdict for damages for the results of a collision resulting from the negligence of those operating the road is properly rendered against the company.[4]

in his service, for the reason that it is his duty to enforce the observance of care by them. He is held liable to those injured by the failure by him to perform this duty. But this has no application to the present case. Here the defendant, by the act of the law, has been deprived of the possession of the road, and of all control over those engaged in operating it; and by like act the possession and control has been given to others. The defendant had not, therefore, anything to do with operating the road. True, if profits were earned thereby, they would inure to the benefit of the defendant by becoming assets for the payment of debts. But this did not make it liable for the conduct of those in no sense its employees or servants. The employees must look to those who employed them for compensation, and those who contracted with the receiver or assignee must also look to him. He was liable for the breach of contracts made by him, and for injuries sustained by his negligence or that of his employees in their performance." Rogers *v.* Wheeler (1871), 43 N. Y. 598.

Under the Iowa Code, § 1289, a receiver operating a railroad, and not the company, is the proper party defendant in an action to recover double damages for stock killed upon the railroad. Brockert *v.* Central Iowa Ry. Co. (1891), 82 Iowa, 369; s. c. 47 N. W. Rep. 1026.

[1] Davis *v.* Duncan (1884), 19 Fed. Rep. 477, 481.

[2] Railroad Co. *v.* Brown (1873), 17 Wall. 445.

[3] Texas & Pac. Ry. Co. *v.* Gay (1894), 86 Tex. 571; s. c. 26 S. W. Rep. 599.

[4] Pennsylvania R. Co. *v.* Jones (1894), 155 U. S. 333; s. c. 15 Sup. Ct. Rep. 136, citing Railroad Co. *v.* Brown, *supra*.

The Washington Supreme Court has

§ 704. **Liability of Company, after being restored to Possession, for Claims arising during the Receivership.** — An order discharging the receiver, restoring the property to the company, and requiring all claims against the receiver to be presented to the court before a certain date, in default whereof they are to be barred, does not preclude a plaintiff whose claim is not presented within that time from recovering a personal judgment against the company, on the ground that the earnings of the receivership out of which the claim should have been paid were used in making permanent improvements which have inured to the company's benefit.[1]

Although the receiver thus discharged may have been appointed by a federal court, the action on the claim may be maintained in a State court, not merely because the proceeding is not one *in rem*, but because the property is no longer in the custody of the federal court after the discharge of its receiver. There is no principle by virtue of which a court can, under such circumstances, be held to have parted with its jurisdiction over property, by the complete surrender thereof to its owner, and at the same time to have constructively retained jurisdiction over the property, so as in that respect to bind those who would otherwise be unaffected by its orders.[2]

Such a claim may also be enforced by a bill in equity to subject the property to its payment, if no third party's rights have intervened, and the injured person was given no opportunity of bringing an action against the receiver prior to his discharge.[3]

If no such application of the earnings to permanent improvements is shown, the claimant will apparently have no remedy

held that the receivers of a railroad company could not be held liable for failing to carry out a contract of the company for transportation made before their appointment. Casey *v.* Northern Pac. R. Co. (Wash., 1896), 48 Pac. Rep. 53, following Scott *v.* Railway Co., 13 Wash. 108; s. c. 42 Pac. Rep. 531.

[1] Texas R. Co. *v.* Bloom (1894), 60 Fed. Rep. 979; Texas & Pac. Ry. Co. *v.* Huffman (1892), 83 Tex. 286; s. c. 18 S. W. Rep. 741.

[2] Texas & Pac. Ry. Co. *v.* Johnson, (1894), 151 U. S. 81; s. c. 14 Sup. Ct. Rep. 250.

A receiver who is operating a railroad under the appointment and direction of a court is included under the terms "persons owning or operating railways," in contemplation of §§ 1278, 1307, of the Code; and such receiver, or rather the property in his hands, is liable for the claim of an employee for injuries received through the negligence of co-employees. Sloan *v.* Central Iowa Ry. Co. (1883), 62 Iowa, 728; s. c. 16 N. W. Rep. 331; 11 Am. & Eng. R. R. Cas. 145.

Sec. 1309, Code Iowa, provides that a judgment against any railway corporation for any injury to any person or property shall be a lien on the company's property prior and superior to the lien of any mortgage or trust deed executed since the 4th day of July, 1862, *held* constitutional. Central Trust Co. *et al.* *v.* Sloan (1885), 65 Iowa, 655; s. c. 22 N. W. Rep. 916; 23 Am. & Eng. R. R. Cas. 398.

[3] Davis *v.* Duncan (1884), 19 Fed. Rep. 477, 481; s. c. 17 Am. & Eng. R. R. Cas. 295.

against the company on the property after the receiver is finally discharged; at all events, after the end of the term in which the decree discharging him was entered. The question presented is then one merely of jurisdiction, and the court has no power to resume control of the property under such circumstances.

A shipper of stock over a railroad in the hands of a receiver after its sale, in an action to recover damages against the company or purchaser, must show that the receiver received funds during his management and turned them over to the company or purchaser, or permanently improved the property therewith.[1]

A railroad company was held liable for damages incurred by negligence of employees during a receivership, its property having been returned to it without sale, and the receivers having expended the earnings during their administration in betterments of the road.[2]

Article II. — Liabilities of Receiver.[3]

§ 705. **Liability of Receiver that of Common Carrier.** — The liability of a receiver operating a railroad is that of a common carrier in regard to the persons with whom they deal in their official capacity.[4]

§ 706. **Liability of Receiver not usually personal.** — The general rule is that a receiver is not personally liable, either in contract or tort, for anything which he does in his official capacity. Being the officer and representative of the court, subject to its orders, accountable in such manner and to such persons as the court may direct, the receiver, as such, has no personal interest, but that arising out of his responsibility for the correct and faithful discharge of his duties. It is of no consequence to him how, or when, or to whom, the court may dispose of the funds in his hands, provided the order or decree of the court furnishes to him a sufficient protection.[5]

[1] Holman *v.* Galv., H. & S. A. Ry. Co. (Tex. Civ. App., 1896), 37 S. W. Rep. 464.

[2] Texas & Pac. Ry. Co. *v.* Gaal (Tex. Civ. App., 1896), 37 S. W. Rep. 462.

[3] Articles on this subject may be found in 4 So. L. Rev. N. S. 18; 17 Am. L. Rev. 833.

[4] Blumenthal *v.* Brainerd (1866), 38 Vt. 402; Morse *v.* Brainerd (1869), 41 Vt. 550; Cutts *v.* Brainerd (1870), 42 Vt. 566; Newell *v.* Smith (1877), 49 Vt. 255; Paige *v.* Smith (1868), 99 Mass. 395; Little *v.* Dusenberry (1884), 46 N. J. L. 614; Klein *v.* Jewett (1875), 26 N. J. Eq. 474; Meara's Admrs. *v.* Holbrook (1870), 20 Ohio St. 137; Toledo, Wabash, & Western Ry. Co. *v.* Beggs (1877), 85 Ill. 80; Kinney *v.* Crocker (1864), 18 Wis. 74; Douglass *v.* Cline (1877), 12 Bush (Ky.), 673, 688.

[5] Beverley *v.* Brooke (1847), 4 Gratt. 187.

A receiver appointed by the trustees in a deed of trust executed by a trading

A receiver, therefore, is not personally liable for the torts of his employees committed in respect to any property which he holds in his official capacity. It is only when he himself has committed the wrong that he incurs any personal liability.[1]

Thus, if they wilfully and corruptly exceed their powers, they are liable for the actual damage sustained by their misconduct.[2]

So, also, where the purchaser of receivers' certificates payable to bearer, which have false representations upon their face as to full compliance with the order of court authorizing their issue, fails in a suit to enforce them against the property upon which they were stated to be a lien, he has a cause of action for damages against the receiver personally, and can recover upon proving the intent to defraud by executing the certificates and placing them upon the market. But he cannot recover upon them as warranties.[3]

The Kansas act of 1874, ch. 94, entitled "An Act relating to the killing or wounding of stock by railroads," applies to receivers operating a railroad under an appointment of a court of competent jurisdiction.[4]

But a receiver is not exempt from personal liability for negligence of which he or his employees may be guilty in respect to

company, under a provision authorizing them to make such appointment as if they were mortgagees, such receiver to be deemed the agent of the company and be in the same position as a receiver appointed by the mortgagee under the English Conveyancing Act of 1881, is a mere agent, and incurs no personal liability in carrying on the business. Owen *v.* Cronk (C. A., 1895), L. R. 1 Q. B. 265. But receivers and managers appointed by the court at suggestion of debenture-holders are court officers, not agents of the company to make contracts on its behalf, nor are they agents of bondholders. They may be personally liable. See De Grille, Houdret, & Co. *v.* Bull (1894), 10 Reports Q. B. 98. See also Burt, Boulton *v.* Bull (1895), L. R. 1 Q. B. 276.

[1] Camp *v.* Barney (1875), 4 Hun, 373; Davis *v.* Duncan (1884), 19 Fed. Rep. 477, 480; Farmers' Loan & Trust Co. *v.* Central R. Co. of Iowa (1883), 17 Fed. Rep. 758; McNulta *v.* Lockridge (1891), 141 U. S. 327; Erskine *v.* McIlrath (1895), 60 Minn. 485; s. c. 62 N. W. Rep. 1130; Cardot *v.* Barney (1875), 63 N. Y. 281.

In Turner *v.* Indianapolis, B. & W. R. Co. (1879), 8 Biss. 527, 532, this freedom of the receiver from personal liability was referred to as being somewhat doubtful. The court said: "The operation of a railroad by a court through a receiver is something out of the routine duty of the courts and receivers. There must be exceptional rules applicable to such receivers. The receiver holds the property for preservation, and it may be questionable whether the receiver should be himself personally responsible in damages for the negligence of his employees, and whether public policy does not require that the receiver, as the organ of the court merely, should be answerable under his contract as operator of the road." But the doctrine stated in the text is fully established by the later cases, and was the one actually applied by the learned judge, who expressed himself with so much hesitation.

[2] Stanton *v.* Alabama & Chattanooga R. Co. (1895), 2 Woods, 506.

[3] Bank of Montreal *v.* Thayer (1881), 7 Fed. Rep. 622.

[4] Rouse *v.* Redinger (Kans. Ct. of App., 1895), 41 Pac. Rep. 433.

property which he is administering by virtue of a contract, and not by virtue of the order of appointment. Such is the position of a railroad receiver with regard to that part of the system which lies outside the State in which he is appointed, unless he is accepted in the foreign jurisdictions as ancillary receiver; for, without such acceptance, his acts can have no official character.[1]

§ 707. **Receiver officially liable to Third Persons for the Torts of his Employees.** — In some cases the courts have expressed themselves rather hesitatingly as to the extent and nature of official liability of a receiver for injuries resulting from his operation of the road.[2]

But it is in accordance with sound principle and reason that a receiver exercising the franchise of a railroad should be amenable, in his official capacity, to the same rules of liability that are applicable to the company while it exercises the same powers of operating the road, and the great preponderance of authority is in favor of this doctrine.[3]

The fact that a receiver is an officer of the court appointing him does not make him a "public officer," exempt, as such, from liabilities for injuries sustained by the negligent discharge of the

[1] Kain *v.* Smith (1880), 80 N. Y. 458; s. c. 2 Am. & Eng. R. R. Cas. 545, distinguishing Cardot *v.* Barney (1875), 63 N. Y. 281.

[2] Cardot *v.* Barney (1875), 63 N. Y. 281 (the real scope of this decision was explained in Kain *v.* Smith (1880), 80 N. Y. 458); Smith *v.* Potter, Receiver, etc. (1881), 46 Mich. 258; Davenport *v.* Receivers (1875), 2 Woods, 519; Turner *v.* Indianapolis, B. & W. R. Co. (1879), 8 Biss. 527. In Davenport *v.* Receivers, *supra*, it was denied that the lien of a judgment recovered for personal injuries received by one travelling on a road operated by receivers was paramount to that of the mortgage bondholders, either as regards the earnings of the business or the proceeds of the foreclosure sale, unless it is so provided in the order of the court placing the road in the hands of the receivers. In Turner *v.* Indianapolis, B. & W. R. Co., *supra*, the court, while not laying down any general principle, held that damages to engines rented to a receiver were properly paid out of the earnings in his hands.

[3] Sprague *v.* Smith (1877), 49 Vt. 421; Little *v.* Dusenberry (1884), 46 N. J. L. 614; Klein *v.* Jewett (1875), 26 N. J. L. 474; Kain *v.* Smith (1880), 80 N. Y. 458; Melendy *v.* Barbour (1884), 78 Va. 544; s. c. 25 Am. & Eng. R. R. Cas. 622 (1884); Winboum's Case (1886), 30 Fed. Rep. 167, and the cases cited in the note to High Rec., § 395. See also the cases collected in the notes to 9 Am. & Eng. R. R. Cas. 723, and 17 Am. & Eng. R. R. Cas. 308.

In Meara's Admr. *v.* Holbrook (1870), 20 Ohio St. 137, the court said: "The reasons for holding a receiver answerable in his official capacity are stronger than those for holding him personally liable only. For where the receiver is not in default himself, there is a hardship in making him personally liable for the negligence of those he employs, not for his own benefit or profit, but for that of the fund he controls; and on the other hand, those having grievances growing out of his official business may be practically remediless, if they are left to the personal responsibility of the receiver only, and are not permitted to pursue him in his official capacity, and obtain redress from the funds in his hand as receiver."

duties imposed on him, even though he is appointed by virtue of a statute empowering him to operate the railroad for the use of the public. His position is rather like that of a body of commissioners or trustees incorporated for the public benefit, whose wrongful acts give the injured person a right to be compensated out of the funds which they have under their control, their private means being exempt from liability.[1]

Nor can they be exempted from liability to third persons on the ground that they are agents or trustees; for, as to the public and their employees, there is no tangible principal behind them.[2]

Proceedings against a receiver, as such, for the torts of his employees are in the nature of a proceeding *in rem*, and render the property in his hands, as such, liable for compensation for such injuries.[3]

The degree of care which a receiver is bound to exercise in operating a railroad is the same as that which is incumbent upon a railroad company.[4]

§ 708. **Receiver, whether suable on Cause of Action arising prior to Appointment.** — Whether the receiver can be made a defendant where the cause of action arose prior to his appointment depends, according to a late case decided by the New York Court of Appeals, upon whether he is a statutory receiver, appointed for the purpose of winding up the affairs of the corporation, or a receiver appointed *pendente lite* to preserve the subject-matter of the litigation. In the latter case, since the company is still liable for its acts, after as before the appointment of the receiver, and can sue and be sued, it is error to make him a party defendant in an action to recover damages for a tort committed while the company was operating the road.[5]

In the former case, as they are vested with all the real and personal estate of the corporation, and the corporation ceases to be an active legal entity, the mere fact that the cause of action arises from the acts of the company will not constitute any reason why a court in which leave has been obtained to sue the receiver should refuse to entertain the suit. He takes the trust estate

[1] Little *v.* Dusenberry (1884), 46 N. J. L. 614; Meara's Admr. *v.* Holbrook (1870), 20 Ohio St. 137.

[2] Meara's Admr. *v.* Holbrook (1870), 20 Ohio St. 137.

[3] Davis *v.* Duncan (1884), 19 Fed. Rep. 477, 480. Compare McNulta *v.* Lockridge (1891), 141 U. S. 327.

[4] Fullerton *v.* Fordyce (1894), 121 Mo. 1; s. c. 25 S. W. Rep. 587.

[5] Decker *v.* Gardner (1891), 124 N. Y. 334; s. c. 26 N. E. Rep. 814; 9 Ry. & Corp. L. J. 308 distinguishing the Missouri case cited below. Compare to the same effect Finance Co. of Pennsylvania *v.* Charleston, C. & C. R. Co. (1891), 46 Fed. Rep. 508.

subject to all the debts and liabilities existing against it at the time of his appointment, whether they arise from contract or tort, and no court except the one appointing him has anything to do with the general question, how the assets are to be applied to the claims of the various creditors.[1]

§ 709. **Receiver's Liability for Injuries to his own Employees.** — Apart from statute, a receiver operating and controlling a railroad in the usual manner, and exercising the duties, powers, and rights of the company, is liable for injuries to his employees in the same manner and to the same extent as the corporation itself would have been had he not been appointed.[2]

His liability for injuries caused by a defect in the road is the same whether the defect existed at the time he took possession, or was incident to his own management.[3]

As to the effect of the various statutes extending the common-law liability of an employee to his servants, the authorities exhibit a conflict which can apparently be attributed only to a real divergence of views, and not to the difference in the wording of the enactments.

In Georgia, where the common-law rule prevails as to all employees except railroad companies (Code, sects. 2202, 2083, 3033, 3036), it has been denied that a servant of a receiver of a railroad can hold such receiver liable for injuries resulting from the negligence of a fellow-servant. The ground was taken that the employees of receivers were not within the words of the Code, and that "to extend those words by construction, so as to subject the company's assets to pay damages for the carelessness or misconduct of men whom neither the officers nor agents of the company had any part in selecting, would be attended with difficulties both technical and practical."[4]

[1] Combs *v.* Smith, Receiver (1883), 78 Mo. 32; s. c. 20 Am. & Eng. R. R. Cas. 209. The distinction taken by the New York court was not noticed, and there is nothing in the report to show that it was recognized. In so far as the case may have been intended to lay down any wider doctrine, it is declared in the New York case just cited to be opposed to the general current of the authorities.

[2] Graham *v.* Chapman (1891), 33 N. Y. St. Rep. 349; s. c. 11 N. Y. Supp. 318; 58 Hun, 602.

[3] Texas & Pac. Ry. Co. *v.* Geiger (1890), 79 Tex. 13; s. c. 15 S. W. Rep. 214.

[4] Henderson *v.* Walker (1875), 55 Ga. 481; Thurman *v.* Cherokee R. Co. (1876), 56 Ga. 376. These cases have been followed by a federal court sitting in Georgia. Central Trust Co. *v.* East Tennessee, Va. & Ga. Ry. Co. (1888), 69 Fed. Rep. 353. See also Central Trust Co. *v.* East Tennessee, Va. & Ga. Ry. Co. (Mitchell, Intervener), (1895), 69 Fed. Rep. 357, and Baltimore Trust & Guaranty Co. *v.* Atlanta Traction Co. (Bennett, Intervener), (1895), 69 Fed. Rep. 358, as to the application of a similar statute in Ohio, act of April 2, 1890 (Laws Ohio, 1890, 149). In an action against a receiver, see Peirce *v.* Van Dusen (1897), 78 Fed. Rep. 693.

Upon the same principle of strict construction of a statute in derogation of the common law, it has been held in Texas that a statute giving a right of recovery for death caused by the negligence of the "proprietor, owner, charterer, or hirer of" any railroad, or their servants, no recovery can be had for a death caused by the negligence of a receiver or his employees.[1]

Where the statute of the State where an action is brought in a federal court entitles an employee to recover from the receiver for injuries arising from the negligence of a co-employee, such recovery will not be prevented by the fact that the courts of the State in which the corporation was organized have denied that there is any right of recovery under the statute of that State.[2]

In Kansas a diametrically opposite construction had been placed on a similar statute, applying to railroads only (Gen. Stat. 1889, par. 1251), the court taking the view that an action against a receiver is, in substance, one against the corporation, and that the case of an injury to the servant of a receiver fell within the spirit, if not the letter, of the law.[3]

§ 710. **How far Receiver is bound by Company's Contracts generally.** — The contracts of the company are not obligatory on the receiver except in so far as he may adopt them.[4]

Nor is he bound to adopt its contracts, or otherwise step into its shoes, if in his opinion it would be unprofitable to do so; and he is entitled to a reasonable time to elect whether to adopt or repudiate any such contracts.[5]

[1] Burke *v.* Dillingham (C. C. A., 1894), 60 Fed. Rep. 729; Allen *v.* Dillingham (1894), 8 C. C. A. 544; s. c. 60 Fed. Rep. 176; Dillingham *v.* Scales (Tex. Civ. App., 1894), 24 S. W. Rep. 975; Texas & Pac. Ry. Co. *v.* Bledsoe (1893), 2 Tex. Civ. App. 88; s. c. 20 S. W. Rep. 1135; Texas, etc. Ry. Co. *v.* Collins (1892), 84 Tex. 121; s. c. 19 S. W. Rep. 365; Yoakum *v.* Selph (1892), 83 Tex. 607; s. c. 19 S. W. Rep. 145. These cases all rest upon the authority of Turner *v.* Cross (1892), 83 Tex. 218; s. c. 18 S. W. Rep. 578, reported in 8 C. C. A. 548, where the question was elaborately discussed.

[2] Texss & Pac. Ry. Co. *v.* Cox (1892), 145 U. S. 593; s. c. 12 Sup. Ct. Rep. 905.

[3] Rouse *v.* Harry (1895), 55 Kan. 589; s. c. 40 Pac. Rep. 1007; Hornsby *v.* Eddy (1893), 5 C. C. A. 560; s. c. 56 Fed. Rep. 461. In the latter case it was pointed out that the statute, if in derogation of the common law, was also remedial, and that, as it was of that nature, the plaintiff was entitled to invoke an interpretation which would give effect to the intention of the law-maker. Considering the condition of affairs which resulted from the appointment of a receiver, there could, it was thought, be no doubt that the legislature could not have intended to make any distinction between the employees of the railroad and the employees of the receiver.

[4] Kansas Pac. Ry. Co. *v.* Bayles (1894), 19 Col. 348; s. c. 35 Pac. Rep. 744; Brown *v.* Warner (1891), 78 Tex. 543; s. c. 14 S. W. Rep. 1032; 45 Am. & Eng. R. R. Cas. 95.

[5] Sunflower Oil Co. *v.* Wilson (1892), 142 U. S. 313; 48 Am. & Eng. R. R. Cas. 664; United States Trust Co. *v.* Wabash Western Ry. Co. (1893), 150 U. S. 287; Seney *v.* Wabash Western Ry. Co. (1893), 150 U. S. 310.

"They continue the operation of the road and the conduct of its business, because this is essential to its proper preservation. They may fulfil the contracts of the corporation, so far as beneficial. They may not pay its debts, nor fulfil its contracts which are burdensome, or tend to diminish the value of the property in their control, unless such contracts are charged as incumbrances on the property, or are necessary to its proper preservation and security." [1]

A contract entered into by one of the constituent companies of a system of railways for an allowance to it by the others on interchanged business of an amount sufficient to pay its operating expenses, the interest on its bonds, and other fixed charges, may be renounced by the receivers of the company representing the whole system, under direction of the court; and the court may then order the earnings to be divided between those companies upon a mileage basis, as it may deem just; and upon its being shown by the receivers that this produces a deficit in the operation of that road, the court may order this deficit made good from the earnings of the property of the different contracting parties upon the basis of the original contract. But in case then the trustees of the bondholder of the latter companies proceed to foreclose their mortgages, impounding the revenues of the several companies, this last order would no longer be applicable, and will not be enforced after the filing of the bills of foreclosure impounding the revenues of those companies.[2]

A railroad company in Virginia sold its telegraph line to a telegraph company. The telegraph company agreed to do tele-

[1] Ellis *v.* Boston, Hartford, & Erie R. Co. (1871), 107 Mass. 1, 28, per Wells, J.

As to receiver's liability to account for and apply the income of a leased road in accordance with the covenants of the lease, see Charlotte, C. & A. R. Co. *v.* Chester & L. Narrow-Gauge R. Co. (N. C., 1896), 24 S. E. Rep. 769.

[2] Ames *et al. v.* Union Pac. Ry. Co. *et al.* (1896), 73 Fed. Rep. 49. The court, *arguendo*, said, on p. 57: "The filing of a proper bill of foreclosure of a mortgage covering the income of a railroad company undoubtedly impounds the revenues of that company for the benefit of its mortgage bondholders, but it does not impound its gross revenue. It impounds only the net revenues that remain after the payment of the operating expenses of the railroad, and such preferential claims as may be allowed under the settled rules of the law. Trust Co. *v.* Riley, 70 Fed. Rep. 32; s. c. 16 C. C. A. 610, 614; St. Louis, A. & T. H. R. Co. *v.* Cleveland, C. C., & I. Ry. Co., 125 U. S. 658, 673, 678.

The payment to connecting lines of railroad of their just and equitable share of the earnings from interchanged business is one of the necessary expenses of operating a railroad. The result is that the revenues from business interchanged with other roads derived by a railroad company or its receiver after a bill for the foreclosure of a mortgage upon it has been filed may be, and ought to be, justly divided among the roads interchanging the business, and that portion of it which equitably belongs to "other roads or their owners is not impounded by the foreclosure."

graph service for the railroad company for a specified time and on specified terms. The railroad company was placed in the hands of a receiver in foreclosure proceedings, which the federal court treated as a creditor's bill. The receiver, upon presentation to him after his possession of a bill for telegraph tolls, asked the court appointing him for instructions. The court directed its receiver to pay the bill, among other reasons because the telegraph company's recorded claim was a valid lien in favor of laborers in the law of Virginia, having priority as such over the claims of the creditors under the mortgage deed.[1]

The interests of the creditors are controlling in the determination of the question whether or not a receiver shall adopt a lease or other contract.[2]

A receiver's ratification of a contract may be implied from his conduct with respect to the subject-matter. Thus he becomes the assignee of the company as to a contract made by it for the lease of rolling-stock, and is bound to perform the covenants therein as to the care and return of the cars, if he has the use and benefit of the cars, with knowledge of the terms of the lease.[3]

Where the receiver elects to return equipment used under a lease, the lessor is entitled to a reasonable notice that the contract is about to be terminated, so that he may have an opportunity to inquire as to the most advantageous way of disposing of it when it is thrown on his hands.[4]

Contractors to erect a building for a railroad company which goes into the hands of a receiver are entitled to the contract price up to the time when they are directed by the receiver to cease work.[5]

A claim under a contract with a receiver of a railroad company in foreclosure proceedings for the complete construction of a building which had been commenced under a contract with the company prior to the receivership, the plans of which were submitted to the court and approved, and which by the findings of the trial court were upon land not covered by the mortgage, and were for the advantage of the railroad, have been held to have been properly allowed a preference over the bondholders in an order for payment by the receivers.[6]

[1] Western Union Tel. Co. *v.* Thom (1894), 72 Fed. Rep. 712.

[2] New York, P. & O. R. Co. *v.* New York, L. E. & W. R. Co. (1894), 58 Fed. Rep. 268.

[3] Easton *v.* Houston & Texas Central R. Co. (1889), 38 Fed. Rep. 784.

[4] Farmers' Loan & Trust Co. *v.* Toledo, etc. R. Co. (1894), 1 Toledo Leg. News, 321.

[5] Girard Life Insurance, Annuity, & Trust Co. *v.* Cooper (1892), 51 Fed. Rep. 332; s. c. 2 C. C. A. 245.

[6] Girard Insurance & Trust Co. *v.* Cooper, 162 U. S. 529; s. c. 16 Sup. Ct.

§ 711. **Receiver succeeds to Company's Rights as to Annulment of Contracts.** — No lien upon the accruing fund is created by a contract between the railroad company and an express company, whereby the latter, in consideration of a sum of money loaned to the former, is to be allowed exclusive privileges in conducting its business over the road, and a special contract rate which is to be applied to the extinguishment of the loan. This is simply a contract for the transportation of property and persons over the road, and a receiver cannot be required specifically to perform it.[1]

To fulfil such a contract would be, in effect, to appropriate the use of the property and the earnings of the road *pro tanto* to the payment of the claim of the express company in preference to all others. This a receiver may properly refuse to do in the case of any contract which does not constitute a charge upon the property itself.[2]

On the authority of this case it has been held that a receiver of a street-railway company will not be directed to pay out moneys in his hands for paving the street between and along the tracks, where no lien exists therefor, although there be a specific contract by the company to make such payment.[3]

A receiver will not be compelled to carry out a lease of a road which can only be operated at a loss, unless he had retained possession for such unreasonable time or under such circumstances as will constitute an election to accept the lease.[4]

The right of a railroad company to terminate a license given to another company to use depot grounds and terminal facilities passes to a receiver of the former company.[5]

§ 712. **What Contracts of Company should be carried out by Receiver.** — Contracts made in the ordinary course of business

Rep. 879 (1896), affirming *v.* , 4 U. S. App. 631 ( ).

Mr. Justice Brown, rendering the opinion, said: "The work had been commenced before the receivership, and was done in good faith, for the benefit of the company and the receivers. The building must either have been finished, or the work already done become a total loss to the company. It appears to have been constructed for the accommodation of the officers of the road, and in other respects in furtherance of the interests of the road; and is an asset in the hands of the receivers, which may be sold and the money realized therefrom applied to the payment of the claim. The fact that it is not covered by the mortgage renders it the more equitable that the proceeds of this sale shall be applied to the payment of the cost of its construction." See Vanderbilt *v.* Central R. Co., 43 N. J. Eq. 669.

[1] Express Co. *v.* Railroad Co. (1878), 99 U. S. 191.

[2] Ellis *v.* Boston, Hartford, & Erie R. Co. (1871), 107 Mass. 1.

[3] Union Loan & Trust Co. *v.* Southern California Motor Road Co. (1892), 49 Fed. Rep. 267.

[4] Park *v.* New York, L. E. & W. R. Co. (1893), 57 Fed. Rep. 799.

[5] Comer *v.* Felton (C. C. A., 1894), 61 Fed. Rep. 731.

with a connecting company — as, for example, with reference to a certain mileage to be paid for the cars of one passing over the lines of the other — will, in the absence of some special reason, be kept on foot.[1]

So the receiver should usually be directed to continue a contract with an express company, giving it certain transportation privileges over the railroad company's lines, though he will not be allowed to fulfil such a contract in so far as that would involve giving the express company a preference over the mortgagees and other creditors, unless it actually amounts to a lien on the property paramount to other claims.[2]

So the payment of the remaining instalments of the purchase price of rolling-stock taken under a contract of conditional sale should generally be continued in the interest of all the parties concerned.[3]

But for the purpose of fixing the sum to be paid for the rent of the rolling-stock the court will not consider the terms of the lease itself, if the evidence shows that the lessor company and the railroad company are both dominated by the same persons. To use such a contract as the basis of an accounting would be to disregard the elementary rule which prohibits an agent from undertaking to serve in the same business two principals whose respective interests are antagonistic.[4]

In general it may be said that, whenever the contract is one which good faith would have required the company itself to carry out, the receiver will not be directed to repudiate it, even if it is for the disadvantage of the trust estate. Thus a receiver has been ordered to comply with a contract, made by the company for the supply of rails at a certain price, and assumed by him, although the stipulated price was higher than that for which the rails could then have been bought, and although certain profits from the transportation of ore to the manufacturer, which had been anticipated when the contract was made, had not been realized.[5]

[1] Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1888), 34 Fed. Rep. 254.

[2] Ellis *v.* Boston, Hartford, & Erie R. Co. (1871), 107 Mass. 1.

[3] Frank *v.* Denver & Rio Grande R. Co. (1885), 23 Fed. Rep. 123, 127. See also Eastern Midlands Railway, 66 Law Times, 154, on consolidation by receiver and manager of rolling-stock contracts made by company.

[4] Thomas *v.* Peoria & R. I. R. Co. (1888), 36 Fed. Rep. 808; s. c. 36 Am. & Eng. R. R. Cas. 381, citing for the general principle Wardell *v.* Railroad Co., 103 U. S. 658; s. c. 1 Am. & Eng. R. R. Cas. 427.

[5] Wabash, St. L. & Pac. R. Co. *v.* Central Trust Co. (1884), 22 Fed. Rep. 269.

Similarly, if a receiver recognizes and acts under a pooling contract, in the exercise of the discretion allowed him by the court, good faith requires that the proceeds of the contract which accumulate in the hands of the receiver should be handed over to the other party to the agreement, irrespective of whether it was originally valid or not.[1]

§ 713. **Contract Liabilities of Receivers in Regard to Leased Roads.** — A receiver cannot abrogate a lease, valid as between the lessor and lessee. Between them it must stand until it is abrogated by a resort to some of the conditions contained in it.[2] But as receivers take by order of the court, they do not, by the mere act of assuming possession, become assignees of the term.[3]

The fact that a receiver continues to work a leased line during the period taken in coming to a determination respecting it, does not operate as an adoption of the lease, when the lessor has never demanded a surrender of the road, though entitled do so because of the non-payment of rent.[4]

Nor does such action impose on them the obligation to perform, for that period, the company's contract guarantying interest on the bonds of the lessor.[5]

In the case of an extensive system like the Union Pacific, a period of sixty-five days is not an unreasonably long period for a receiver to spend in ascertaining the situation of affairs, and making up his mind as to whether he will accept or renounce the lease.[6]

But a receiver cannot take possession of the property, and enjoy its use and occupation, without incurring a liability for the pay-

[1] Central Trust Co. *v.* New York & Ohio Central R. Co. (1885), 23 Fed. Rep. 306.

[2] New York, P. & O. R. Co. *v.* New York, L. E. & W. R. Co. (1894), 58 Fed. Rep. 268.

[3] Park *v.* New York, L. E. & W. R. Co. (1893), 57 Fed. Rep. 799, following Quincy, M. & P. R. Co. *v.* Humphreys (1892), 145 U. S. 82, and St. Joseph & St. Louis R. Co. (1892), 145 U. S. 105. To the same effect see Central Trust Co. *v.* Wabash, St. L. & Pac. R. Co. (1888), 34 Fed. Rep. 259; Farmers' Loan & Trust Co. *v.* Northern Pac. R. Co. (1893), 58 Fed. Rep. 257; United States Trust Co. *v.* Wabash Western Ry. Co. (1893), 150 U. S. 287; Seney *v.* Wabash Western Ry. Co. (1893), 150 U. S. 310; New York, P. & O. R. Co. *v.* New York, L. E. & W. R. Co., 58 Fed. Rep. 268. The last of these cases disapproves the doctrine of Brown *v.* Toledo & W. R. Co. (1888), 35 Fed. Rep. 444, as being in conflict with the above-mentioned decisions of the Supreme Court of the United States; but it may possibly be defended on the ground that the terms of the order were such as to create the liability of an assignee. The report of the case is, however, not specific on this point.

[4] New York, P. & O. R. Co. *v.* New York, L. E. & W. R. Co. (1894), 58 Fed. Rep. 268; Ames *v.* Union Pac. Ry. Co. (1894), 60 Fed. Rep. 966.

[5] Ames *v.* Union Pac. Ry. Co. (1893), 60 Fed. Rep. 966.

[6] Ibid.

ment of rent under the lease by which his predecessor secured its possession; and while it is competent for him at any time to negotiate a new contract and secure a modification of its terms, or to repudiate it and surrender the property, yet, if he does not do this, he must be held to have signified his acceptance of it under the terms and conditions of the existing lease as to the payment of rent,[1] especially where the lessor, immediately after the receiver's appointment, demands either an adoption of the lease or a surrender of the road, and, against his protest, a decision is delayed several months.

Where a receiver recognizes and adopts a lease, he is bound to disburse the earnings of the leased road in accordance with the terms of the instrument which is the source of his title to the possession of the property which produces the earnings. If the lease provides that those earnings are to be applied first to the operating expenses, insurance, and taxes, before any interest on the bonds is paid, a payment of interest while the taxes are in default is a diversion of the earnings which the court will order to be restored.[2]

If the lessor makes certain improvements in the property the basis of a demand for an increased rent, and upon the refusal of the receiver to accept the terms proposed the parties enter into a temporary agreement, by which the question of the proper amount of rent is to be submitted to the arbitration of the court which appointed the receiver, the rent to be paid for the period during which the court is considering the matter is not that demanded by the lessor, but that which the evidence shows to be a fair compensation for the property.

The amount which other companies pay for the same facilities is not a proper test of what is a reasonable rent, when such companies own all the stock of the lessor, and their contract with the lessor is, therefore, substantially a contract with themselves.[3]

If it appears that more than the net earnings of the leased property for the period the receivers have held it have been paid to the lessors, the court will instruct the receivers not to pay any more out of the general *corpus* of the estate.[4]

[1] Woodruff *v.* Erie Ry. Co. (1883), 93 N. Y. 609; s. c. 16 Am. & Eng. R. R. Cas. 501.

[2] Clyde *v.* Richmond & D. R. Co. (1894), 63 Fed. Rep. 21.

[3] Farmers' Loan & Trust Co. *v.* Chicago R. Co. (1883), 18 Fed. Rep. 484, affirmed in Peoria & Pekin Union Ry. Co. *v.* Chicago, Pekin, & S. W. R. Co. (1888), 127 U. S. 200.

[4] Park *v.* New York, L. E. & W. R. Co. (1893), 57 Fed. Rep. 799.

In Carswell *v.* Farmers' Loan & Trust Co. of New York *et al.* (1896), 74 Fed. Rep. 88, the receiver in foreclosure proceedings of a railroad company was held

§ 714. **Withdrawal of Consideration of Lease a Sufficient Ground for renouncing it.** — Where the chief consideration moving to the lessee company is that the road of the lessor shall be operated in harmony with, and practically under the supervision of the lessee, the appointment of a separate receiver for the lessor, and his assumption of independent possession and control, operate as a withdrawal of the consideration, and are sufficient, without more, to justify the lessee in renouncing the lease from that time.[1]

§ 715. **Receiver cannot enjoy Benefit of Contract without assuming Burdens.** — The principle that a receiver cannot enjoy the benefit of a contract without assuming its burdens, has been applied in some cases where the vendor of land to the company has required the performance of certain acts as conditions precedent to the passing of a complete title. Thus where the company has agreed, in consideration of a grant of right of way, to erect and maintain a water-tank on the lands of the proprietor, to be supplied with water from an elevated spring thereon, which is to be used by the company, and for which the proprietor is to be paid the compensation usual in such cases, the sum payable under the contract is a charge on the earnings in the hands of the receiver.[2]

So also a receiver must either comply with a judgment against the company, requiring the establishment of a farm-crossing on land taken for the road, or deliver up the land so taken.[3]

§ 716. **When Receiver's Liability, as such, ceases.** — The right of action against receivers necessarily ceases when the property passes out of their control, whether it be by the consummation of the foreclosure sale,[4] or in consequence of their discharge.[5]

A receiver, after his discharge, is not liable in an action for

liable only for a reasonable rental under a contract for lease of a depot, made with the company by a depot company, as the receiver had not elected to adopt the lease, and for the time he had retained possession of the depot, impliedly retained it by consent of the lessor on terms of payment of a reasonable rental.

[1] Ames *v.* Union Pac. Ry. Co. (1893), 60 Fed. Rep. 966.

[2] Howe *v.* Harding (1890), 76 Tex. 17; s. c. 13 S. W. Rep. 41; 42 Am. & Eng. R. R. Cas. 1. The ruling of the court was made independently of statute, but the decision was also inevitable, as was pointed out, under a provision of the Texas Gen. Laws, 1887, p. 121, § 15, declaring that "all judgments, claims, or causes of action when determined, existing against any corporation at the time of the appointment of a receiver, shall be paid out of the earnings of such corporation while in the hands of a receiver, . . . and the same shall be a lien upon such earnings."

[3] Peckham *v.* Dutchess County R. Co. (1895), 145 N. Y. 385; s. c. 40 N. E. Rep. 15.

[4] Farmers' Loan & Trust Co. *v.* Central R. Co. of Iowa (1880), 7 Fed. Rep. 537.

[5] Ryan *v.* Hays (1884), 62 Tex. 42.

damages for injuries received during the time he was operating a railroad.[1]

Otherwise, as a railroad company is not responsible for damages sustained by plaintiff through the negligence of the servants of the receiver, further than they can be paid out of the current receipts of the road while in his hands, it follows that the purchasers will incur no obligation to pay such damages from the mere fact that they purchased the property from those who bought it at the receiver's sale.[2]

But the court may, and frequently does, reserve control of the property to such an extent as may be necessary for the enforcement of unsatisfied claims, and the purchasers of the property will then take it subject to all claims that may be established against the receiver.[3]

Where, after the sale in foreclosure suit, the receiver continues in possession for a time the purchaser will be liable in an action for damages for personal injuries incurred while the road was in possession of the receiver between the date of the sale and the taking possession by the purchaser, to the extent that the receiver may have applied the income to the betterment of the property.[4]

1 Missouri, K. & T. Ry. Co. *v.* Wylie (Tex. Civ. App. 1896), 33 S. W. Rep. 771.

2 Ryan *v.* Hays, Receiver (1884), 62 Tex. 42; s. c. 23 Am. & Eng. R. R. Cas. 501.

3 See, for example, Tex. & Pac. Ry. Co. *v.* Bloom (1894), 60 Fed. Rep. 979; Tex. & Pac. Ry. Co. *v.* Johnson (1894), 151 U. S. 81; Farmers' Loan & Trust Co. *v.* Central R. Co. of Iowa (1880), 7 Fed. Rep. 537.

4 Crawford *v.* Houston & Texas Central R. Co. (Tex., 1895), 33 S. W. Rep. 534.

CHAPTER XXXII.

COMPENSATION OF TRUSTEES, RECEIVERS, AND OTHERS, AND ATTORNEYS, IN SUITS RELATING TO MORTGAGED PROPERTY.

Article I. — Personal Compensation of Trustees, Receivers, etc., for their Services.

§ 717. **Introductory.** — Most of the decisions on the subjects of this chapter deal with questions which were, and must neces-

sarily have been, determined so largely by the special circumstances of each case, and the individual opinion of the judge, that it is not possible to extract definite rules applicable to all cases.[1]

Receiver's certificates issued under decretal orders will be given priority to claims for compensation of trustees in foreclosure proceedings and their solicitors.[2]

But allowances to railroad receivers and their solicitors are chargeable as costs of the proceedings, and will be paid in preference to the certificates of the receiver.[3]

§ 718. **Compensation of Trustees.** — Nothing is better established in England, says Perry, than that a trustee can have no allowance or compensation for his time or trouble in the execution of a trust; but a different principle prevails generally in all the States of this country.[4]

This innovation upon the practice in England has been due partly to the fact that the different social conditions prevailing here have induced the different State legislatures to make statutory provisions for remuneration to executors and guardians, the equity of such statutes being by construction generally extended to conventional trustees where the agreement is silent,[5] and partly to a feeling that, in the words of Judge Story, "the policy of the law ought to be such as to induce honorable men, without a sacrifice of their private interests, to accept the office, and to take away the temptation to abuse the trust for mere selfish purposes, as the only indemnity for services of an important and anxious character."

The latter of these considerations is especially applicable to the trustees of railroad mortgages, who may at any time, owing to the occurrence of the contingencies specified in the mortgage, be required to undertake the performance of delicate and burdensome duties. The allowances made to them, whether expressly stipulated for in the trust instrument, or provided for by the statute, or granted by the court in deference to usage, are made with a view to securing greater activity and intelligence

[1] See on this subject the remarks of Justice Miller in Hinckley *v.* Railroad Co. (1879), 100 U. S. 153, cited below; of Justices Bradley and Miller in Trustees *v.* Greenough (1881), 105 U.S. 527, 535; and of Brewer, J., in Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1887), 32 Fed. Rep. 187; s. c. 2 Ry. Corp. L. J. 492 (see also *post*).

[2] Petersburg Sav. & Ins. Co. *v.* Dellatorre *et al.* (1895), 70 Fed. Rep. 643; s. c. 17 C. C. A. 310.

[3] Ibid.

[4] Perry on Trusts, §§ 904, 918.

[5] Northern Central R. Co. *v.* Keighler *et al.* (1868), 29 Md. 572.

in the performance of the trust, and to inducing persons of reliable character and business capacity to accept the office.[1]

Commissions, therefore, will ordinarily be allowed to such trustees where they have performed their duty, unless its performance has imposed no labor or trouble which justly entitles them to compensation, or there is something in the nature of the trust itself, or in the terms of the trust instrument, to show that no commissions were intended to be allowed or charged.[2]

Compensation can be recovered, in any event, only for such services and expenditures as are within the line of duties imposed upon the trustee by the instrument creating the trust.

A trustee who institutes a suit for the benefit of the bondholders does not lose his right to be compensated for his services merely because the object of that suit is to compel a lessee company to pay a rental for which he is liable as surety, when the evidence shows that he assumed this liability without any consideration, and without the prospect of any personal benefit, and

[1] Story Eq. Jurisp., 1268 *n.*; Trustees *v.* Greenough (1881), 105 U. S. 527; s. c. 12 Am. & Eng. R. R. Cas. 345. There it was said: "In the vast amount of litigation which has arisen in this country upon railroad mortgages, where various parties have intervened for the protection of their rights, the fund has been subjected to the control of the court and placed in the hands of receivers or trustees. It has been the common practice, as well in the courts of the United States as in those of the States, to make fair and just allowances of expenses and counsel fees to the trustees, or other parties promoting the litigation and securing the proper application of the property to the trusts and charges to which it was subject. Sometimes, no doubt, the allowances have been excessive, and perhaps illegal; and we would be very far from expressing our approval of such large allowances to trustees, receivers, and counsel as sometimes have been made, and which have justly excited severe criticism. Still, a just respect for the eminent judges under whose direction many of these cases have been administered would lead to the conclusion that allowances of this kind, if made with moderation and a jealous regard to the rights of those who are interested in the fund, are not only admissible, but agreeable to the principles of equity and justice."

[2] Northern Central R. Co. *v.* Keighler *et al.* (1868), 29 Md. 572. In this case the trustees were authorized, in the event of a sale, to apply the proceeds in the first place "to the payment of all necessary expenses and *reasonable commissions* attending such sale." Before any default had taken place, the trustees brought suit to recover compensation for the administration of the trust, alleging that the custody and care of the bonds, the collection and reinvestment of the money, the keeping of accounts, and the various other duties connected with the office, involved much labor, as well as care and responsibility. It was held that it was not the intention that any commissions should be allowed for such services, both because the trust was, in its nature, somewhat of a public character, and in its execution the complainants were engaged in subserving great and important public interests, and because the deed, by providing for compensation in the event of the sale, negatived the idea that commissions were to be allowed in any other contingency. "If it were supposed," said the court, "that the trust was accepted with the motive of receiving pecuniary reward, it is doing no violence to the terms of the deed to say that the prospect of receiving the large commissions in the event of a sale was regarded as a sufficient consideration for the acceptance of the trust."

in the interest of and for the protection of the bondholders. Under such circumstances it does not lie in the mouth of bondholders who partake of the fruits of his action to argue that he was not acting as their trustee, because he himself was personally liable for the payment of the rentals.[1]

§ 719. **Amount allowed for Personal Compensation of Trustee.** — The amount allowed for the personal services of a trustee is sometimes determined by the provisions of the mortgage.[2] Thus where the trustees, for their services in selling and conveying lands covered by the mortgage, and applying the proceeds to a sinking fund for the discharge of the bonds, are entitled to the sum of two per cent on the par amount of the bonds cancelled in that manner, and bondholders avail themselves of the privilege given them by the trust deed to buy those lands, and pay for them in bonds at their par value, which, when received by the trustees, are to be cancelled by them, the latter transaction will, for the purpose of determining the compensation of the trustees, be regarded as a sale for cash, and they will, therefore, be entitled to two per cent of the par value of the bonds which are thus used in payment of the purchase price of the land sold to the bondholders.[3]

The amount of the remuneration, where it is not fixed by the trust instrument, has, in some States, been provided for by the express statutory provisions, while in others the courts are guided by enactments which, being applicable to persons holding certain fiduciary offices of similar character, are extended by a sort of equitable construction to trustees.[4]

[1] Woodruff *v.* New York, L. E. & W. R. Co. (1891), 129 N. Y. 27; s. c. 29 N. E. Rep. 251; 51 Am. & Eng. R. R. Cas. 89, the court saying that the case came within the meaning and spirit of decision in Trustees *v.* Greenough, referred to below. The two cases are scarcely parallel, for the latter is a distinct authority that one not a trustee cannot, even though performing a trustee's duties, claim a trustee's compensation. The question in the New York case was merely whether the plaintiff was acting as trustee or in a non-official capacity. The court decided that he was a trustee, and the view thus adopted at once took the case out of the category to which Trustees *v.* Greenough belongs.

[2] An instance will be found in Guignon *v.* Union Trust Co. (1895), 156 Ill. 135; s. c. 40 N. E. Rep. 556.

[3] Gilman & Cowdrey *v.* Des Moines Valley R. Co. (1875), 41 Iowa, 22.

[4] For a review of various statutes controlling the question in either of the ways mentioned in the text, see Perry on Trusts. If the trustees are compensated by receiving a certain statutory percentage of the gross amount of the proceeds of the sale of the property, the sum may be charged with the expenses of the master who makes the sale. Duncan *v.* Atlantic, Miss. & Ohio R. Co. (1882), 4 Hughes, 125.

A recent example of the application of the second method of computing the proper allowance, in the case of a railroad trustee, will be found in Woodruff *v.* New York, L. E. & W. R. Co. (1891), 129 N. Y. 27; s. c. 51 Am. & Eng. R. R. Cas. 89; 29 N. E. Rep. 251, where a trustee, suing in his individual name, but really, as was

Even where the allowance is left by the trust instrument to the discretion of the court, as where the mortgage states that the trustees shall receive a reasonable compensation, thus indicating the desire of the parties that it shall be adjusted largely as an equivalent for the responsibility which they have been obliged to assume, the statutory scale of remuneration is not unlikely to be adopted, if it seems, under all the circumstances of the case, to yield a proper amount.[1]

But the adoption of such a standard is only a matter of convenience, and the court, in all cases in which it is free to settle the amount, will do so in view of all the facts presented.[2]

Thus where the services performed in a foreclosure suit by the trustees do not require all, or nearly all, their time, nor interfere with their own business, and they incur no great responsibility, and it appears that, up to the time of the litigation, they have been in the receipt of $1,500 per annum, and that since then they have, as receivers and trustees, been paid $4,500 per annum, an extra allowance is improper.[3]

So also, upon the foreclosure of several mortgages in the same suit, the trustee of one of them, whose services were merely nominal, going no further than the mere use of his name, and who represented the holder of a single bond of $500, the rest having been paid, has been deemed amply compensated by an allowance of $500.[4]

decided, for the benefit of the bondholders, was awarded the same percentage of the fund which he had recovered as was appointed by statute for executors and guardians, the rule in that State being, in the absence of exceptional circumstances, that this percentage is deemed to be a full equivalent for the services performed by persons holding such fiduciary positions.

[1] Dow *v.* Memphis & Little Rock R. Co. (1885), 32 Fed. Rep. 185. In this case the trustee defeated an attempt to set aside the mortgage. The court, in discussing the proper amount of compensation, said: "If the result of the suit had been adverse, they would doubtless have been subjected to criticism, although there would have been no reason for it. The amount involved was very large, and the trustees should not be exposed to contingencies, in which their discretion and fidelity might come in question, without an adequate remuneration." The conclusion arrived at was that one per cent on the whole amount at stake, in addition to their expenses, was, under the circumstances, a fair allowance, that being the usual commission which trustees in the State of New York received. A summary of a master's report recommending various specified sums to be paid to trustees and others in the Wabash litigation will be found in 1 Ry. & Corp. L. J. 598.

[2] The fee bill of the federal courts is intended to regulate only those fees and costs which are strictly chargeable as between party and party, and not to regulate the fees of counsel and other expenses and charges, as between attorney and client, nor the power of a court of equity, in cases of administration of funds under its control, to make such allowances to the parties out of the fund as justice and equity may require. Trustees *v.* Greenough (1881), 105 U. S. 527, 535; s. c. 12 Am. & Eng. R. R. Cas. 345.

[3] Easton *v.* Houston & Texas Central R. Co. (1889), 40 Fed. Rep. 189.

[4] Ibid.

So also $10,000 per annum for a non-resident trustee who attended to the financiering part of the duties in New York, and $15,000 to a resident trustee who operated the road, and received a liberal salary for doing so, has been held to be an excessive allowance, although it was admitted that there had been a vast amount of labor and litigation in connection with the trusteeship, and that the trustees had "really lifted the road out of the mire, and kept the concern going until it could walk alone." The total amount was, therefore, reduced rather more than one-third.[1]

Where the trial courts of a State have established rules fixing the rates of commissions to be allowed to trustees making sales under the orders of such courts, those rules are imperative both upon the courts themselves and all persons accepting trusts at their hands.[2]

§ 720. **Apportionment of Compensation between several Trustees.** — In apportioning compensation between several trustees, reference should be had to the services rendered by each.[3]

For example, where trustees had defended a suit to set aside the trust deed, one trustee had been "active and zealous in consultations with the bondholders and with counsel," the second "especially active in the preparation of evidence" and "unremitting in his efforts from the beginning of the litigation." The third had not "taken an active part in the defence of the suit." Under these circumstances the first was allowed $8,500, the second, $11,500, the third, $6,000.[4]

So, also, where one trustee during pendency of foreclosure suit was active manager of road one hundred and thirty-four miles long, and controlled business amounting to $160,000, while the other trustee resided in a different State, and merely made examination of monthly reports of his colleague, an allowance of $5,000 to the former and $1,500 to the latter was held "eminently proper."[5]

Where a person in first place consents to act as trustee with

[1] Williams *v.* Morgan (1884), 111, U. S. 684; s. c. 17 Am. & Eng. R. R. Cas. 217.

[2] Tome *v.* King (1885), 64 Md. 166; s. c. 21 Atl. Rep. 279.

[3] Dow *v.* Memphis & Little Rock R. Co. (1885), 32 Fed. Rep. 185.

[4] Ibid.

[5] Walker *v.* Quincy, M. & P. R. Co. (1886), 28 Fed. Rep. 734. In Williams *v.* Morgan (1884), 111 U. S. 684; s. c. 17 Am. & Eng. R. R. Cas. 217, the lower court had made allowances to two trustees in possession, giving resident trustee fifty per cent. more than his non-resident colleague, who financiered the road through its embarrassments, and in other ways promoted its interests. This ratio was not disapproved of by the Supreme Court, but the total of the allowances was reduced. (See above.)

a certain number of colleagues for a specific compensation, and afterwards accepts the office with the knowledge that the mortgage, as actually executed, provides for a larger number, he can claim only proportionate share of compensation which is due to him as one of the increased number.[1]

§ 721. **Compensation of Discharged Trustee.** — In the case cited, a trustee who was discharged without his knowledge, after having accepted a trust under a deed which expressly provided for a specific compensation, did not lose his right to that compensation.[2]

§ 722. **Compensation of Successor of Deceased Trustee.** — Such successor is properly allowed the compensation provided for in the mortgage.[3]

§ 723. **Compensation of Representative Bondholders.** — A bondholder suing in behalf of himself and other bondholders does not, in regard to compensation, occupy the same position as a trustee, even though litigation has been rendered necessary because the trustees have neglected their duties, and the result of the bondholder's labors is the rescue and reclamation of the trust fund from waste and destruction. "Where an allowance," said Mr. Justice Bradley, "is made to trustees for their personal services, it is made to secure greater activity and diligence in the performance of the trust, and to induce persons of reliable character and business capacity to accept the office of trustee. These considerations have no application to case of creditor seeking his rights in a judicial proceeding. It would present too great temptation to parties to intermeddle in management of valuable property or funds in which they have only the interest of creditors, and that perhaps only to a small amount, if they could calculate upon the allowance of a salary for their time and having all their private expenses paid."[4]

§ 724. **Compensation of Receivers.** — The amount of compensation which is to be awarded to receivers is left to the discretion of the court, but the amount is discretionary only in the

[1] Maury *v.* Chesapeake & Ohio R. Co. (1876), 27 Gratt. 698.

[2] Ibid.

[3] Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush (Ky.), 673; s. c. 18 Am. Ry. Rep. 221.

[4] Trustees *v.* Greenough (1881), 105 U. S. 527, 535; s. c. 12 Am. & Eng. R. R. Cas. 345.

For rules as to costs in English courts in actions of debenture-holders to enforce their own security, or suits in behalf of themselves and other debenture-holders, see Ford *v.* Earl of Chesterfield, 21 Beav. 426; Thomas *v.* Jones, 1 Dr. & Sm. 134; *Re* Richardson, 14 Ch. Div. 611; Wright *v.* Kirby, 23 Beav. 463; Batten *v.* Dartmouth Harbour Commrs., 45 Ch. Div. 612; *Re* Ormerod, Grierson, & Co. (1890), W. N. 217; Carrick *v.* Wigan Tramways Co. (1893), W. N. 98.

sense that there are no fixed rules to determine the allowance applicable in every case, and the courts are not at liberty to give more than fair and reasonable compensation. The policy of the courts is to see its officers and agents well paid, in order that men of character and ability may be willing to accept the burdens and responsibilities of these trusts; but at the same time it is not to be forgotten that the property to be charged with these allowances is not the property of the court, and that there are many thousands scattered all over the land who are the owners, whose property, by the strong hand of the law, has been taken out of their custody, and who look to the court to see that no unjust or excessive burden is cast upon them. The court may not exercise the generosity of the owners, but is closely limited by the justice of a judge.[1]

In arriving at a conclusion, the court will consider the magnitude of the trust, the care and responsibility, the time occupied, the skill and ability displayed, and the success attained.[2]

If there is nothing in the administration of the trust to convict the receivers of want of integrity or good faith, a lack of foresight in regard to future developments of the business is no reason for denying compensation, or reducing amount, especially where the management has, on the whole, been attended with reasonable success.[3]

[1] Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1887), 32 Fed. Rep. 187 ; 2 Ry. & Corp. L. J. 492, per Brewer, J. In this case, two receivers, who managed the vast Wabash property for three and a half years, were each awarded $112,500 by the master. The court, while admitting that the receivership of such a complicated system cast an immense burden of care and responsibility on the receivers, and required on their part the exercise of the highest skill and ability, and conceding that their administration had been perfectly successful, considered that this sum was rather too large, and reduced the amount to $70,000. A large number of diverse opinions as to proper compensation were given by railroad managers and others, and this amount was fixed upon as being intermediate between the extreme estimates.

The New York act of 1883 (ch. 378, Laws of 1883), in relation to receivers of corporations, including the second section thereof, in reference to receiver's fees, applies only to receivers of corporations appointed in proceedings of bankruptcy or insolvent corporations, and a receiver appointed in an action to foreclose a mortgage executed by a corporation is not entitled to the fees specified in said section. The allowance of commissions to such a receiver is governed by the provision of the Code of Civil Procedure, § 3320, providing for the allowance by the court or judge where not otherwise specially prescribed by statnte. United States Trust Co. *v.* New York, West Shore, & Buffalo R. Co. (1886), 101 N. Y. 478 ; s. c. 5 N. E. Rep. 316 ; 25 Am. & Eng. R. R. Cas. 601.

[2] Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1887), 32 Fed. Rep. 187 ; s. c. 2 Ry. & Corp. L. J. 492.

[3] Cowdrey *v.* Railroad Co. (1870), 1 Woods, 331.

A receiver who resides at a distance from the property, and takes no part in active management of road, cannot claim same compensation that is usually paid to railroad presidents and receivers who are active executive heads.[1]

An order making an allowance to a receiver should be definite, showing not only for what services made, but also upon what basis, whether by analogy to rate of commissions allowed trustees, or on ground that peculiar circumstances of case justify higher rate.[2]

Compensation of receiver who retains office after duties and responsibilities of practical management of property have ceased should be less than during the period when he was in full control of business.[3]

The Maryland Court of Appeals, while conceding that the rule for compensating a receiver is not of the same invariable character as that which restricts the compensation of a trust to the rate established by general rules of court, considered that, in the absence of special circumstances, the allowance of a receiver should conform as nearly as possible to rate of commissions given to guardians and trustees for performance of like or kindred services.[4]

In the federal courts, however, and perhaps most of the States, the rule prevailing in Maryland, that the compensation of a receiver should, in the absence of some special reason, be the same as that of a trustee, apparently is not observed, the amount being left to the discretion of the judge.[5]

Allowance of Additional Compensation to Receiver. — The fixing of rate of compensation in order of appointment, and assent of receiver thereto, does not preclude him from subsequently claiming an additional amount, where he performs duties outside those imposed by acceptance of office. A case for allowing extra compensation arises where receiver acts as superintendent of road, and, by serving as attorney, saves the *per diem* fees due

[1] Central Trust Co. *v.* Cincinnati, J. & M. R. Co. (1892), 58 Fed. Rep. 500.

[2] Tome *v.* King (1885), 64 Md. 166; s. c. 21 Atl. Rep. 279.

[3] Boston Safe Deposit & Trust Co. *v.* Chamberlain (1895), 66 Fed. Rep. 847. In this case receiver had received $6,000 a year for managing road 170 miles long, which produced only gross revenue of $200,000, while there was an annual deficit of $50,000. He had also, by appointment of another court, acted as special receiver of same road, considered as branch of extensive system, and as special master to sell the road. The court held that $1,750 was sufficient compensation for seven months' services, while he was winding up the receivership, after road had passed into hands of purchasers at foreclosure sale.

[4] Tome *v.* King (1885), 64 Md. 166; s. c. 21 Atl. Rep. 279.

[5] See cases already cited in this section.

under a regular contract with another attorney,[1] and where the condition of the road, and litigation respecting it, are such as to necessitate work and travel at night and outside usual hours of business.[2] But no allowance will be made to him for saving salaries of employees, effected by abolishing one office and imposing duties on another. Nor can he claim commission on amount paid out in connection with administration of road by predecessor. In neither case has he done more than was required by his contract to discharge duties of his office with fidelity and economy.[3]

§ 725. **Method of determining Amount of a Receiver's Compensation.** — In fixing amount of compensation, it is irrelevant to inquire what another competent person would have been willing to do the work for.[4]

Expert evidence is usually taken by court; but the wide differences of opinion which such evidence is sure to elicit show no fixed standard or rule to guide the court, which must, therefore, fall back upon its own judgment of what, under the circumstances, will be fair and reasonable compensation for services.[5]

Nor should too much weight be attached to testimony of other receivers who believe that sums which they are paid for their services on other roads, and which happened to be about the same as that claimed by the petitioner, are a just and fair compensation for the discharge of their duties.[6]

1 Farmers' Loan & Trust Co. *v.* Central Railroad Co. of Iowa (1881), 8 Fed. Rep. 60.

2 Ibid.

3 Ibid.

A receiver of a street-railway company was appointed in March, 1891, and operated the road. In September, 1892, a decree of foreclosure was entered. In January, 1893, a decree was entered upon a report of the master that the receiver be allowed $5,000 for his services and $2,500 for the services of his attorney. In July, 1894, another decree was rendered, a reference made to the master, and report made that he be allowed $2,400 more, and his attorneys $1,500 additional. The Judge disallowed these last amounts. U. S. Circuit Court of Appeals affirmed this disallowance. Montgomery *v.* Petersburg Sav. & Ins. Co. *et al.* (1895), 70 Fed. Rep. 746.

4 Cowdrey *v.* Railroad Co. (1870), 1 Woods, 331.

5 Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1887), 32 Fed. Rep. 187; s. c. 2 Ry. & Corp. L. J. 492. In this case the highest estimate was about $36,000 a year, the lowest was $6,000, with numerous amounts intermediate between these.

6 Hinckley *v.* Railroad Co. (1879), 100 U. S. 153. Mr. Justice Miller remarked: "Perhaps they were the best judges of the value of their own services; but such is not always the case, and as this is the first time we have been called on to review the allowance made to receivers in the Circuit Courts, we do not see that the economical administration of insolvent companies will be promoted, or that justice requires a higher standard of compensation than these courts generally give, to whose discretion the subject must be

ARTICLE II. — EXPENSES OF TRUSTEES, RECEIVERS, AND OTHERS.

§ 726. **Expenses of Trustees, including Expenses for Attorneys and Counsel.** — "Trustees," says Perry, "have an inherent right to be reimbursed all expenses which they reasonably and properly incur in the execution of the trust, and it is immaterial that there are no provisions for such expenses in the instrument of trust. If a person undertakes an office for another in relation to property, he has a natural right to be reimbursed all the money necessarily expended in the performance of the duty."[1]

Among such expenses are the fees of counsel employed to defend a suit in which the validity of the mortgage is attacked, and the various disbursements made in procuring necessary evidence, and in other ways protecting the interests of the *cestuis que trust* during the progress of the litigation.[2]

The same rule as to counsel fees prevails when a bill is filed by the trustee to preserve the estate from waste or destruction,[3] or to foreclose the trust mortgage.[4] But a trust company, which has been compelled to come into court in order to collect from the receiver of a railroad company certain rentals justly due, cannot claim compensation for the services of its solicitors in procuring the order for payment when such services were entirely for its own benefit, and not for the purpose of adding to the fund which is to be distributed to the creditors in general.[5]

largely remitted. There the receiver claimed $1,000 a month, and was allowed only $10,000 for services for nearly two years.

[1] Cited with approval in Rennselaer & Saratoga R. Co. *v.* Miller (1874), 47 Vt. 146.

Trustees of a trust deed are entitled to indemnity for their disbursements in preference to debenture-holders. See *In re* Exhall Coal Co., *Re* Bleckley, 35 Beavan, 449. In a winding up of a company such charges were ordered by the court to be paid after the costs of sale and the costs and remuneration of the receiver. Batten *v.* Wedgwood Coal & Iron Co. (1884), L. R. 28 Ch. Div. 318.

[2] Downs *v.* Memphis & Little Rock R. Co. (1885), 32 Fed. Rep. 185.

[3] Morton *v.* New Orleans & Selma R. Co. (1885), 79 Ala. 590.

[4] Mercantile Trust Co. *v.* Missouri, K. & T. R. Co. (1889), 41 Fed. Rep. 8; s. c. 7 Ry. & Corp. L. J. 30.

The costs which by Acts 23d General Assembly of Iowa, ch. 48, relating to laborers' claims against corporations in the hands of receivers, are to be paid before such claims, include fees of the receiver of the corporation and his attorney, but not compensation to a trustee and his attorney for services in a suit to foreclose a mortgage on the corporate property. St. Paul Title Ins., etc. Co. *v.* Diagonal Coal Co. (Iowa, 1895), 64 N. W. Rep. 606.

As to allowances to a receiver, as compensation for services, expenses of administration of the trust, and counsel fees, see Cake *v.* Woodbury (1894), 3 App. Cas. (D. C.) 60.

[5] Central Trust Co. *v.* Valley Ry. Co. (1893), 55 Fed. Rep. 903; Trustees *v.* Greenough (1881), 105 U. S. 527; Invest-

A solicitor who contracts with a trustee for a retainer fee to be paid for services in a foreclosure suit, and thereafter commences and prosecutes a suit for some time, does not lose his right to compensation for the reason that the proceedings are interrupted by a civil war, at the end of which all the trustees are dead, and the foreclosure is ultimately effected at the instance, not of the solicitor who resumes the former suit, but of certain bondholders with whom he has no dealings. But he cannot, under such circumstances, claim the whole amount contracted for.[1]

A clause by which the mortgagor agrees to pay all the fees and charges of the trustees in executing the trust justifies an allowance of reasonable counsel fees for foreclosing the mortgage.[2] But to make such a provision effectual as against the mortgagor, it must be shown to have been inserted under proper authority.[3]

A vote of the directors, empowering the president and secretary to execute a mortgage, does not authorize the insertion of a contract therein obligating the corporation to pay the mortgagee's counsel fee in case legal proceedings are taken to enforce the lien. Nor will the ratification of a mortgage, invalid because authorized by a meeting of which some of the board had no notice, be deemed to include such a provision, where the directors have no knowledge of its contents, except as indicated by the order made for its execution at the first meeting.[4]

§ 727. **Expenses of Representative Bondholders.** — A bondholder, suing in behalf of himself and other bondholders, for the purpose

ment Co. of Philadelphia *v.* Ohio & N. W. R. Co. (1891), 46 Fed. Rep. 696; and Easton *v.* Houston & Texas Central R. Co. (1889), 40 Fed. Rep. 189; in all of which the allowance of counsel fees was made in favor of parties suing for the benefit of a class of creditors.

[1] Cowdrey *v.* Galveston, H. & H. R. Co. (1876), 93 U. S. 352. Mr. Justice Field said: "The fact that the retainer was by the trustees in the mortgage who have since died, and that the present suit was presented by the bondholders, the *cestuis que trust*, does not affect the position of the claim. The trustees, had they lived, would have been entitled to retain out of the funds received by them sufficient to meet the claims. They would have had an equitable right not merely to be reimbursed from such funds all reasonable expenses incurred, but also to retain from the funds sufficient to meet all reasonable liabilities contracted in the execution of their trust from the time of the employment of the intervener. The funds derived from the mortgaged property were chargeable with the liability consequent upon the retainer; and it matters not whether those funds were obtained by the trustees, or, in consequence of their death, or of the action of the court, by other parties having charge of the property." The lower court reduced the claim one-half, and no objection was made in the appellate court to the reduction.

[2] Guignon *v.* Union Trust Co. (1895), 156 Ill. 135; s. c. 40 N. E. Rep. 556.

[3] Schallard *v.* Eel River Steam Nav. Co. (1886), 70 Cal. 144; s. c. 11 Pac. Rep. 590.

[4] Pacific Rolling Mill *v.* Dayton, Sheridan, & Grande Ronde Ry. Co. (1881), 5 Fed. Rep. 852.

of protecting the security, is entitled to be allowed his counsel fees and other legitimate expenses out of the trust fund. Such a bondholder does not stand merely in the position of a creditor seeking satisfaction of his debt, and therefore having no right to allowances for any expenses beyond taxed costs as between party and party. In Trustees *v.* Greenough,[1] the leading case on this point, the court said: "In a case like the present, where the bill was filed not only in behalf of the complainant himself, but in behalf of the other bondholders having an equal interest in the fund, and where the bill sought to rescue that fund from waste and destruction arising from the neglect and misconduct of the trustees, and to bring it into court for administration according to the purposes of the trust; and where all this has been done, and done at great expense and trouble on the part of the complainant, and the other bondholders have come in and participated in the benefits resulting from his proceedings, — if the complainant is not a trustee, he has at least acted the part of a trustee in relation to the common interest. He may be said to have saved the fund for the *cestuis que trust*, and to have secured its proper application to their use. There is no doubt, from the evidence, that, besides the bestowment of his time for years almost exclusively to the pursuit of this subject, he has expended a large amount of money for which no allowance has been made, nor can properly be made. It would be very hard on him to turn him away without any allowance except the paltry sum which could be taxed under the fee bill. It would not only be unjust to him, but it would give to the other parties entitled to participate in the benefits *of the fund an unfair advantage.* He has worked for them as well as for himself; and if he cannot be reimbursed out of the fund itself, they ought to contribute their due, a portion of the expenses which he has fairly incurred. To make them a charge upon the fund is the most equitable way of securing such contribution." It is clearly inequitable for one bondholder alone to bear the burden of such litigation, and allow others to come in and reap its fruits, when the result inures equally to the benefit of the whole class. The attorneys for the original complainant are also the attorneys for all who unite with him in the suit, or who are afterwards permitted by the court to come in and participate in the proceedings.[2]

Upon analogous principles, where the result of a bondholder's suit, filed in behalf of the whole class, was not the actual appoint-

[1] 105 U. S. 527, 535; s. c. 12 Am. & Eng. R. R. Cas. 345 (1881).

[2] Morton *v.* New Orleans & Selma R. Co. (1885), 79 Ala. 590.

ment of a receiver, but the rendition of a decree directing the company's officers themselves to make returns of the earnings to the court for the information and protection of the bondholders, it was declared to be inequitable that such bondholders as refused to unite in the suit should be allowed to reap the benefit of complainant's action, and bear no proportion of the costs.[1]

"The underlying principle," it has been said, "in all the cases in which one has been allowed compensation out of a common fund belonging to others for expenses incurred and services rendered in behalf of the common interest is the principle of agency. Such charges are allowed, not simply because services have been rendered which have been beneficial to the common interest, but upon the ground that they were rendered by the authority of those having the common interest exercised by the representative, the compensation for which was to be chargeable to the fund protected or recovered."[2]

For this reason, where a representative bondholder is made defendant in a suit to determine the priority of the bonds held by his co-bondholders, as against those held by the bondholders for whom the suit is instituted, it is only the fees of the counsel retained by the defendant representative that are chargeable on the common fund, though other counsel employed by other bondholders of the same class render valuable services in bringing about a successful issue of the suit.[3]

§ 728. **Expenses of Pledgees of Bonds.** — Pledgees of bonds, who are holders for value only to the extent of the advances on the bonds and interest, have no lien on the bonds for counsel fees in a foreclosure suit to which they are made parties defendant for the purpose of determining the validity of these bonds.[4]

§ 729. **Expenses of Receivers in Conduct of Litigation.**[5] — Receivers are entitled in the settlement of their accounts

[1] Stewart *v.* Chesapeake & Ohio Canal Co. (1881), 5 Fed. Rep. 149, 158. In this case the court directed the clerk to tax as part of the costs of complainant the expenses of printing the various pleadings, exhibits, and briefs of the respective parties. On the other hand, no expenses will be allowed in a case of this kind, unless those which the representative himself has express or implied authority to incur.

[2] Hand *v.* Savannah & Charleston R. Co. (1883), 21 S. C. 162, per Simpson, C. J.

[3] Hand *v.* Savannah & Charleston R. Co. (1883), 21 S. C. 162. See also § 732, below.

[4] Morton *v.* New Orleans & Selma R. Co. (1885), 79 Ala. 590. "Counsel fees," said the court (p. 623), "can form no part of the debt, because they accrued as an independent obligation, and after the pledge was made, and the bonds were never transferred with any intention of securing such a claim."

[5] See further, *post*, as to the more general question of what a court will allow in passing a receiver's accounts.

to payments made on account of legal services and counsel fees.[1]

The professional services of a counsel are deemed to be covered by an order appointing a receiver and directing him to pay debts "owing to the laborers and employees" of the company for "labor and services actually done" in connection with the company's railways.[2]

§ 730. **Expenses of Mortgagors in Conduct of Litigation, including Expenses for Counsel.** — A lawyer in the employ of the company, which is placed in the hands of a receiver, is not entitled to receive payment of his salary out of the proceeds of the sale, prior to the satisfaction of the mortgage bonds,[3] and the various liens, demands, and expenses in the foreclosure suit.[4]

No allowance, therefore, can be made to the mortgagor's counsel, where the sale of the property will not realize enough to satisfy the mortgage.[5]

Counsel fees for services rendered to a railroad company, in a suit in which a construction contract is declared invalid, but the contractor is awarded compensation for the work actually performed by him, are not entitled to priority over a lien which a statute creates in favor of a contractor who does work for a railroad.[6]

§ 731. **Allowance of Costs as between Different Mortgagees.** — The English rule as to costs where there are several mortgages has been stated as follows by Daniell (Chancery Pleading and Practice, * 1390): "The mortgagee is entitled to the payment of his costs before the subsequent mortgagees receive any part of their principal, interest and costs, the practice of the court being to direct each mortgagee to be paid his principal, interest and costs according to his priority. But it has been held that,

[1] High on Rec., § 805; McLane *v.* Placerville & Sacramento Valley R. Co. (1885), 66 Cal. 606; s. c. 26 Am. & Eng. R. R. Cas. 404.

[2] Gurney *v.* Atlantic & Great Western Ry. Co. (1874), 58 N. Y. 358. In Hammond *v.* Atlee (Tex. Civ. App., 1897), 39 S. W. Rep. 600, a receiver, who was an attorney, whose compensation was fixed at $100 a month, made a contract with another attorney to divide a ten per cent fee, recoverable on certain claims of the insolvent company, equally between them. The court held that the portion reserved for himself could not be allowed to the receiver, as such a contract on his part inured only to the advantage of the trust.

[3] Finance Co. of Pennsylvania *v.* Charleston, C. & C. R. Co. (1893), 52 Fed. Rep. 526.

[4] Blair *v.* St. Louis, H. & K. R. Co. (1884), 20 Fed. Rep. 351.

[5] Mercantile Trust Co. *v.* Missouri, K. & T. R. Co. (1889), 41 Fed. Rep. 8; s. c. 43 Am. & Eng. R. R. Cas. 469.

[6] New Castle N. Ry. Co. *v.* Simpson (1886), 26 Fed. Rep. 133, decided with reference to the Pennsylvania Resolution of 1843.

where a mortgagee commences or adopts a suit for the administration and sale of the mortgagor's estate, he does not rest exclusively on his contract, but seeks something beyond it, and the costs of his suit are the first charge if the estate proves deficient."

So where a mortgagee sets up an unfounded claim or an unjust defence, he will be deprived of his costs. Where, however, the contest is chiefly between a first and a third mortgagee, the position of the latter being that the former had no lien, it is not equitable to charge the gross proceeds with the costs and expenses of the suit, and so prejudice a second mortgagee who did not institute the litigation, and has a lien upon only a portion of the road. In such a case it was ordered that one half of the costs should be paid out of the funds which were going to the first mortgagee, and the other half out of the funds which were going to the second, unless the property proved to be sufficient to pay all the mortgage creditors and their costs, in which event the costs, etc., were to be paid at the expense of the defendant company.[1]

§ 732. **Costs of Unsecured Creditors seeking to enforce Claims against Receivers.** — It has been stated above that a bondholder suing in behalf of all secured creditors is entitled to have his counsel fees charged upon the fund reclaimed by him. A similar principle governs the case in which the establishment of the claim of an unsecured creditor inures to the benefit of the whole class in which he belongs. The solicitor to whose exertions this result is due has a lien upon the property for fees, the amount of which is computed with reference, not to the claims of his actual clients, but to the aggregate of all the claims of the creditors of the same class.[2]

[1] Meyer *v.* Johnston (1875), 53 Ala. 237; s. c. 15 Am. Ry. Rep. 467.

[2] Central Railroad & Bkg. Co. of Georgia *v.* Pettus (1885), 113 U. S. 116, 125. The railroad companies in possession of the property argued that the utmost the court could do was to charge upon it such expenses as the solicitor's clients themselves incurred, and that the compensation claimed in respect to claims filed by other holders of unsecured bonds should not be allowed. The Supreme Court of the United States disagreed with this contention, saying: "When the litigation was commenced, these unsecured bonds were without any value in the financial market. That litigation resulted in their becoming worth all, or nearly all, that they called for. The creditors who were entitled to the benefit of the decree had only to await its execution in order to receive the full amount of their claims; and that result was due to the skill and vigilance of these solicitors, so far as the result of litigation may, in any case, be referred to the labor of counsel. When creditors filed their claims, they had notice by the bill that the suit was brought, not exclusively for the benefit of the complainants therein, but equally for those of the same class who should come in and contribute to the expenses of the litigation. Those expenses necessarily included reasonable counsel fees, which, upon every

Petitions by interveners in foreclosure suits which are in the nature of claims against receivers, and ask for order of the court that the receivers pay them, are mere interlocutory applications, and the order thereon, whether granting or refusing the power of the application, are not final hearings or decrees within the meaning of section 824 of the United States Revised Statutes; and no docket fee for final hearing should be taxed thereon.[1]

§ 733. **Sheriff's Fees.** — Where a code provides certain fees for a sheriff conducting a foreclosure sale in which the execution plaintiff becomes the purchaser, he is entitled to the same fees if one not a party to the suit becomes the bidder and then transfers his bid to the trustee.[2]

§ 734. **Amount of Attorney and Counsel Fees allowed in Foreclosure in Discretion of Court.**[3] — These amounts will, of course, depend upon whether it goes through simply by default, or is defended, giving rise to questions of considerable importance, in the settlement of which a large amount of time and labor is expended.[4]

In a case in which "the services were rendered under the eye of the court, and, in the foreclosure proceedings proper, there was no substantial contest, the whole matter being practically

gronnd of justice, should be estimated with reference as well to the claims of the complainants who undertook to protect the rights of all the unsecured creditors as of the claims of those who accepted the fruits of the labors of complainants and their solicitors. This compensation of the solicitors should be made with reference to the amount of all claims filed in the cause, although the evidence thereof may have been retained in the custody of the respective creditors; excepting from such estimate or calculation not only the claims of the complainants named in the bill, and of the unsecured creditors who may have had special contracts with these solicitors or settled with them, but also snch claims purchased by the companies holding the property, as were not filed for allowance under the decree." The court reduced the allowance made by the trial jndge one-half, thus giving the solicitor the same percentage of the claims of the creditors who were not parties as he had contracted for with his immediate clients.

[1] Missouri Pac. R. Co. *v.* Tex. & Pac. R. Co. (1889), 38 Fed. Rep. 775.

[2] Gilman *v.* Des Moines Valley R. Co. (1876), 42 Iowa, 495.

[3] Bronson *v.* La Crosse & Milwaukee R. Co. (1884), 2 Wall. 283.

[4] Walker *v.* Quincy, M. & P. R. Co. (1886), 28 Fed. Rep. 734. In this case two counsel were awarded $5,000 and one $2,000 for a litigated suit.

An assistant employed by the counsel appointed by the court to act as legal adviser to the receivers in the Wabash litigation was awarded by the Western master $7,500 for services extending over about four years and a half, the report stating that his special duties bronght him more frequently before the court than any other solicitor in the cause. In the same report it was recommended that the solicitor of the Wabash Railway Company, at whose instance the receivers were appointed, should receive the same amount. These allowances seem not to have been excepted to by the purchasing committee. The master's report is summarized in 1 Ry. & Corp. L. J. 598.

carried out in pursuance of a plan of reorganization," the court was of opinion that $100,000 was an ample compensation for the solicitors representing the trustees of the several mortgages in suit.[1]

Large allowances pending a receivership are to be deprecated. The proper time to examine and settle such matters as counsel fees is at the end of the litigation. All allowances made in the meantime for professional services should be small.[2]

For services of counsel relating solely to the receivership, a fair and just method of compensation is by annual allowance rather than by attempting to value each item of service.[3]

Article III. — Out of what Funds Compensation and Expenses in Foreclosure Suits are paid.

§ 735. **Mortgaged Property must in general bear Expenses of its Administration in Court of Equity.** — It is by this fundamental principle that allowances to trustees for counsel fees and other expenses are justified.[4]

This principle is, of course, equally applicable whether the estate is in the hands of a trustee properly so called, or of a receiver, and, by analogy, where a receiver is asked for, and the court, instead of appointing an officer of its own to conduct the business, leaves it in charge of the company's agents, directing them to report the amount of the earnings for the information and protection of the mortgagees.[5]

[1] Easton *v.* Houston & Texas Central R. Co. (1889), 40 Fed. Rep. 189.

[2] Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1885), 23 Fed. Rep. 675, per Brewer, J., who reduced a fee allowed by the master from $6,000 to $2,000.

[3] Boston Safe Deposit & Trust Co. *v.* Chamberlain (C. C. A., 1895), 66 Fed. Rep. 847.

[4] Trustees *v.* Greenough (1882), 105 U. S. 527, 535; s. c. 12 Am. & Eng. R. R. Cas. 345; Morton *v.* New Orleans & Selma R. Co. (1885), 79 Ala. 590.

[5] Stewart *v.* Chesapeake & Ohio Canal Co. (1881), 5 Fed. Rep. 149, 158.

In Coe *v.* Columbus, Piqua, & Indianapolis R. Co. (1859), 10 Ohio St. 372, it was considered that the trustees who file a bill for foreclosure of the mortgage do not come before the court in the character of trustees of any property or fund which would authorize the court to charge upon that property or fund their expenses. "They have not," it was reasoned, "and have never been, in possession of the property. They hold a legal title as security for certain creditors of the company, and, in substance, it is the same thing, for the purposes of this action, as if the title had been conveyed directly to the creditors. There was a convenience in selecting some person to take the title for the benefit of those to whom the bonds might be negotiated. The mortgagees in this case, who assumed that office, might very properly have stipulated with the company for a compensation, and perhaps did so. But we cannot now recognize them in any other character than as ordi-

Most of the cases within the scope of this treatise which illustrate this principle are cases where the mortgage is being foreclosed and a receiver is appointed, or the trustees have entered into possession; but the same principle is operative whatever the nature of the suit may be by which the trust is being enforced. Thus it has been adjudged that costs should follow a bill to redeem filed by a junior mortgagee whose rights were held not to have been cut off by the decree, and that those costs should be charged upon the property.[1]

If a suit is pending against a railroad company when the receiver is appointed, and the receiver, being ordered to defend the suit, engages the services of the counsel retained by the company, the trust fund is chargeable with the fees earned by services during the receivership, but not those earned prior to the time when the court assumed control of the property. As to the latter his claim is against the company, and can be paid only from the surplus in hand after the satisfaction of the various liens, demands, and expenses of the foreclosure suit.[2]

§ 736. **Necessary Charges Lien on Mortgaged Property.** — The manner in which the above principle is worked out by the courts is to make the necessary charges of managing the trust estate a first lien upon it.[3] Thus a claim of a trustee for his personal services constitutes a lien upon the trust estate, and he will not be compelled to part with the legal title of the property until the claim is satisfied.[4]

The operation of this rule cannot be evaded by an arrangement under which the bondholders secured by a mortgage subsequent to that foreclosed pay the amount of the redemption money fixed by the decree directly to the parties represented by the trustee who controlled the suit. Since he could have

nary mortgagees, and feel no more at liberty to pay them for their trouble, or to pay them their counsel fees, out of the proceeds of a sale of the property, than we would in any ordinary case." This view of the position of a mortgage trustee seems to be altogether opposed to that which is held by the majority of the courts.

[1] Simmons v. Taylor (1885), 23 Fed. Rep. 849.

[2] Blair v. St. Louis, H. & K. R. Co. (1884), 20 Fed. Rep. 351.

A purchaser opposing the confirmation of the foreclosure sale, though the decree may be set aside and he released from his bid, will be allowed ordinary taxable costs, but not his counsel fees and expenses, out of the trust fund. Farmers' Loan & Trust Co. v. Green (1897), 79 Fed. Rep. 222.

Salary, expenses, and costs of a receiver are payable from the fund realized. Batten v. Wedgwood Coal & Iron Co., 28 Ch. Div. 317.

[3] Perry on Trusts, 907.

[4] Rensselaer & Saratoga R. Co. v. Miller (1874), 47 Vt. 146.

retained enough of that money, if it had come to his hands, to satisfy his reasonable charges for services and disbursements, a court of equity will not accede to an application to compel him to convey the legal title thus left outstanding in him, unless the petitioners consent to do what he could have done for himself, if the arrangement which prevented his having control of the money had not been made.[1]

So also receivers and trustees are entitled to repayment of their reasonable expenses and charges, in preference to all other claims upon the property of whatever nature.[2]

The general principle also avails in favor of one who, by his professional services in behalf of the unsecured creditors, establishes their right to be paid a portion of the money in the receiver's hands. The fee thus earned is a lien upon the fund reclaimed.[3]

A solicitor who is employed by the receiver to sue for a tract of land held adversely, agreeing to accept as his fee one-half the recovery, is entitled, after the sale of the entire property of the company, to pursue the proceeds and establish his claim against the fund instead of the land.[4]

Where a large body of land is conveyed to trustees to secure the payment of the principal and interest of a great number of railroad bonds which have a long time to run before maturity, and the grantor, the railroad company, in the trust deed reserves the right to sell the lands and pay the proceeds of the sales thereof to the trustee, after deducting expenses incurred in executing the trust, it may retain the proper amount for expenses in making the sales, and may also pay the taxes out of the proceeds thereof.[5]

§ 737. **Lien for Counsel Fees.** — The lien for counsel fees will not be lost by reason of death of the trustee who employed the counsel subsequent to the commencement of the foreclosure proceedings, and the litigation being subsequently carried through by a bondholder. From the time of the retainer the funds to be derived from the mortgaged property are chargeable with the liability consequent upon the retainer, and it matters not whether those funds are obtained by the trustee, or in con-

[1] Rensselaer & Saratoga R. Co. *v.* Miller (1874), 47 Vt. 146.

[2] Ellis *v.* Boston, Hartford, & Erie R. Co. (1871), 107 Mass. 1; McLane *v.* Placerville & Sacramento Valley R. Co. (1885), 66 Cal. 606.

[3] Central Railroad & Bkg. Co. *v.* Pettus (1885), 113 U. S. 116. For a more extended statement of this case, see above.

[4] Hand *v.* Savannah & Charleston R. Co. (1883), 21 S. C. 162.

[5] Nickerson *v.* Atchison, Topeka, & Santa Fé R. Co. (1881), 17 Fed. Rep. 408.

sequence of his death, or of the action of the court, by other parties having charge of the property.[1]

§ 738. **General Fund, when Chargeable and when not.** — Ordinarily the allowances considered in the present chapter are payable out of the general fund involved in the litigation.[2]

A trustee in a divisional mortgage who is made party to a suit brought to foreclose a general mortgage junior to his, and incurs expenses in employing counsel to defend his interests, is entitled to have those expenses allowed out of the fund in the hands of the receiver, even where he has withdrawn from the litigation and taken proceedings to enforce his own mortgage.[3] But this rule is qualified wherever its operation would be inequitable, as in a case in which a judgment creditor of an insolvent corporation seeks to set aside an assignment of the property in trust for the benefit of certain bondholders, who are eventually declared to have a prior claim upon the proceeds of the property.

Under such circumstances the creditor is suing in antagonism to the preferred bondholders, and, as the efforts of the counsel are valuable to him precisely in the same proportion as they are detrimental to his adversaries, it would clearly be unjust to charge the fees of such counsel upon the trust fund in such a manner as to diminish the amount payable to the bondholders. Reasonable counsel fees, however, may properly be allowed out of any fund that may remain after paying costs of the suit, and discharging the preferred claims.[4]

Similarly an attorney who appears by the direction of the trustee of one class of bonds, in a suit in which the liability of a railroad company to taxation is successfully resisted, is not entitled to be paid out of the common fund, when another class of bondholders, whose claim that fund is insufficient to satisfy, are declared to have a prior right to it. As none of the class whom the attorney represented can participate in the distribution of the fund, it follows, of necessity, that their attorney, who can claim only through them, is in like manner excluded. The mere fact of his services having inured to the ultimate advantage of the prevailing class of bondholders does not strengthen his claim, as this result is merely one of the inci-

[1] Cowdrey *v.* Galveston, H. & H. R. Co. (1877), 93 U. S. 352.

[2] Hand *v.* Savannah & Charleston R. Co. (1882), 17 S. C. 219; s. c. 12 Am. & Eng. R. R. Cas. 495, and the cases cited in the preceding sections of this chapter.

[3] Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1888), 36 Fed. Rep. 622.

[4] Morton *v.* New Orleans & Selma R. Co. (1885), 79 Ala. 590.

dental advantages which sometimes go beyond the immediate object of the employment. For such benefits the law gives no compensation.[1]

So, also, where the mortgage provides that the trustees shall be "entitled to receive proper compensation for every labor or service performed in the discharge of such trust in case they shall be compelled to take possession of said premises, or any part thereof, and manage the same," they should not, in a suit brought by the company to redeem the estate, after the trustees have gone into possession, be allowed the fees of counsel employed in the suit, nor the amount of an insurance procured without the permission of the mortgagor. Such expenditures are in the interest of the bondholders, and must be met by them.[2]

Costs awarded in favor of the party who is finally decided to have a legal title to certain rolling-stock which he has released to a receiver under an agreement that he shall, upon the determination of the controversy in his favor, be paid a specified sum as the price, are not a lien on the general fund, even though the sum itself which is to be paid under the agreement is expressly made chargeable as a first lien on the property by virtue of the authority conferred on the receiver by the court.[3]

§ 739. **Liability of Prior Mortgagee for Expenses of Suit by Junior Mortgagees.** — Where a receiver is appointed at the instance of the trustee of a second mortgage, the trustee of the first mortgage not being made a party to the suit, and taking no part in the proceedings except to intervene by petition and join in two unsuccessful efforts to make a sale, and the property is finally decreed to be sold subject to the first mortgage, the bondholders secured by that mortgage are not liable for any costs or any expenses except those incurred through the intervention of their trustee, and his participation in the two unsuccessful attempts to effect a sale. They cannot be assessed for the commissions of the trustee of the second mortgage or of the receiver. If the proceeds of the sale are insufficient to afford adequate security and indemnity to the trustees and receivers, the parties at whose instance the proceedings were instituted will be required to provide the means of payment.[4]

[1] Hand *v.* Savannah & Charleston R. Co. (1883), 21 S. C. 162.

[2] Boston & Worcester Railroad Corporation *v.* Haven (1864), 8 Allen (Mass.), 359.

[3] Vilas *v.* Page (1887), 106 N. Y. 439; s. c. 13 N. E. Rep. 743.

[4] Tome *v.* King (1891), 64 Md. 166; s. c. 21 Atl Rep 279.

Article IV. — Practice.

§ 740. **Proper Time to settle Compensation and Expenses.** — The proper time to settle allowances is at the end of the litigation. Thus receivers will not be allowed to pay more than a part of the fees of their counsel pending a foreclosure suit. The balance must stand until the close of the proceedings, when the court will decide what final allowance is to be made.[1]

The ordinary course is to allow, out of the funds produced by the sale or use of the mortgaged property, the amount due to the trustees for personal services and expenses incurred in the execution of the trust, before paying anything to the bondholders.[2]

The decree of foreclosure may direct the Master in Chancery to inquire as to the proper compensation for the trustees and their counsel, and this inquiry may be proceeded with after the confirmation of the sale under the decree.[3]

§ 741. **Trustee's Claim for Compensation and Expenses, how asserted after Redemption of Property.** — Where the trustees in a first mortgage have foreclosed it, and junior mortgagees redeem the property by payment of the amount fixed in the decree, the trustees may file a cross-bill to assert their lien for services and expenses, and have the proper amount fixed in that manner.[4]

§ 742. **Rehearing after Remand by Appellate Court.** — Where the lower court has determined the amount of the fund to be distributed, and awarded the claimant a certain percentage for the personal services, which, for reasons assigned, exceeds that prescribed by statute, and an appeal is thereafter taken upon the question whether anything is really due on account of those services, the appellate court will not, if the question is decided in the claimant's favor, but the statutory amount deemed to be adequate, order a rehearing for the purpose of settling the sum to be paid. The commission being thus referred to, a definite

[1] Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1885), 23 Fed. Rep. 675.

[2] Smith's Execrs. *v.* Washington City, Va. Midl. & Great Southern R. Co. (1880), 33 Gratt. (Va.) 617; s. c. 1 Am. & Eng. R. R. Cas. 493; Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush (Ky.), 673; s. c. 18 Am. Ry. Rep. 221; Bronson *v.* La Crosse & Milwaukee R. Co. (1864), 2 Wall. 283; Mercantile Trust Co. *v.* Missouri, K. & T. R. Co. (1889), 41 Fed. Rep. 8; s. c. 43 Am. & Eng. R. R. Cas. 469.

[3] Walker *v.* Quincy, M. & P. R. Co. (1886), 28 Fed. Rep. 734.

[4] Rensselaer & Saratoga R. Co. *v.* Miller (1874), 47 Vt. 146.

standard can be accurately computed without the necessity of further proceedings.[1]

§ 743. **Exceptions to Amounts allowed by the Master, etc.** — Exceptions to the amounts allowed by the master for the salaries of the various officers employed by a receiver should be precise and raise well-defined issues. A vague exception launched at the compensation generally of all the officers indiscriminately, and not stating what compensation was allowed to any one of them, will be overruled.[2]

[1] Woodruff *v.* New York, L. E. & W. R. Co. (1891), 129 N. Y. 27; s. c. 29 N. E. Rep. 251; 5 Am. & Eng. R. R. Cas. 89.

[2] Stanton *v.* Alabama & Chattanooga R. Co. (1875), 2 Woods, 506.

CHAPTER XXXIII.

FORECLOSURE DECREES.

Article I. — Provisions of Decree.

§ 744. **Conformity of Decree to Provisions of Mortgage.** — Since the parties to the mortgage are at liberty to regulate, by express agreement therein, the manner in which the property subjected to the lien shall be disposed of in case of default, the power of the court may sometimes be limited by the contents of the instrument. But the precise method by which effect is to be given to stipulations of this sort is necessarily a matter within the control of the court. Thus where the mortgage stipulates that there shall be no judicial sale for cash unless the amount bid at the sale shall equal the sum due to the bondholders, and as an alternative appoints a method by which a reorganization of the debtor company is to be effected in accordance with the

wishes of the majority of such bondholders, it is not error to decree that the mortgaged property shall be sold to the highest and best bidder, and that the trustee shall be authorized and directed to bid at the sale, as trustees for the first-mortgage bondholders, at least, the amount of principle and interest of the bonds.[1]

Nor can a stipulation as to terms of a sale under the power in the mortgage — as that the bonds should in such a case be received as part of the price, at a rate to be fixed in a certain manner — be construed so as to bind the court in regard to a sale in foreclosure proceedings.[2]

§ 745. **Conformity of Decree to Bill.** — The general rule, that a complainant cannot be awarded by a decree more than he claims in his bill, is applicable to a decree *pro confesso* as well as others. Thus it is erroneous, where such a decree has been entered in a suit to foreclose for default in the interest only, and the sale consummated and confirmed, to make a further decree that the complainant recover of the company the balance of the principal of the bonds, left after applying the proceeds of the sale to their payment, there being no provision in the bonds or mortgage whereby such principal can be declared due before the date of their maturity.[3]

[1] Sage *v.* Central Railroad Co. (1878), 99 U. S. 334, 341.

[2] Farmers' Loan & Trust Co. *v.* Green Bay & Minnesota R. Co. (1881), 10 Biss. 207; s. c. 6 Fed. Rep. 100. In the course of his opinion, Judge Dyer said: "The sale authorized in the mortgage was one to be made in certain contingencies by the trustee. It was a sale to be made in accordance with the stipulations of the parties. The course of procedure there prescribed was one to be pursued in case of a sale without foreclosure, and it was competent and proper for the parties to place upon the trustee certain restrictions, and to define the limits within which he must act in making such a sale. But those provisions could not bind the court if foreclosure proceedings should be instituted, and a sale should be made under its directions. In such case the sale would have to be made according to the usual course of practice in judicial proceedings, and the court would be no more bound to adopt the provisions of the mortgage as to the acceptance from a purchaser of bonds to apply to his bid, or the proportion in which bonds should be so received, or the manner in which their value should be ascertained, than it would be to adopt the directions to the trustees contained in the mortgage as to the advertisement of the property for sale. Undoubtedly the court might adopt, so far as practicable, the method of procedure pointed out in the mortgages; but it would not be error affecting the validity of the decree not to do so, unless wrong and injustice were apparent in the decree, and I am unable to perceive wherein the decree in the particular under consideration fails to recognize the rights of all parties."

[3] Ohio Central Ry. Co. *v.* Central Trust Co. of New York (1890), 133 U. S. 83; s. c. 10 Sup. Ct. Rep. 235. "The fact that a bill was taken as confessed," said Chief Justice Fuller, "did not of itself justify giving complainant more than it claimed. Under the rules and practice of this court in equity, a decree *pro confesso* is not a decree as of course,

But a decree is not open to objection merely because it determines matters not specifically presented by the bill. Thus, as

according to the prayer of the bill, nor merely such as the complainant chooses to take it, but that it is made, or should be made, by the court according to what is proper to be decreed upon the statements of the bill assumed to be true. If the allegations are distinct and positive, they may be taken as true without proof; but if they are indefinite, or the demand of the complainant is in its nature uncertain, the requisite certainty must be afforded by proof. But in either event, although the defendant may not be allowed on appeal to question the want of testimony or the insufficiency or amount of the evidence, he is not precluded from contesting the sufficiency of the bill, or from insisting that the averments contained in it do not justify the decree.

"Under the 18th rule in equity, where the bill is taken *pro confesso*, the cause is 'proceeded in *ex parte*,' and the matter of the bill may be decreed by the court; and hence, if a decree be passed not confined to the matter of the bill, it may be attacked on appeal for that reason. By the 92d rule it is provided that in suits in equity for the foreclosure of mortgages 'a decree may be rendered for any balance that may be found due to the complainants over and above the proceeds of the sale or sales.' Assuming that a deficiency decree might be rendered in the absence of a specific prayer for that relief, nevertheless the case made by the bill must show that the amount is due; for otherwise it cannot properly be found so. This rule does not authorize the Circuit Courts to find a balance due because partial extinguishment has been effected by a sale, if, as a matter of fact, the indebtedness is not then payable.

"The bill here did not seek relief as to the second mortgage, which is only referred to as a subordinate lien, nor did it claim that anything except interest was due upon the first mortgage. It sought the establishment and enforcement of the first-mortgage lien and the foreclosure of the equity of redemption. The amount realized paid the outstanding interest and a part of the principal. Under such circumstances and upon these pleadings the deficiency decree, which is a judgment for the recovery of so much money with execution, was improvidently entered. Without discussing the extent of the franchises authorized to be sold under the mortgage, we are of opinion that the appeal was properly taken in the name of the defendant company."

The provision of the New York Code of Civil Procedure, § 1207, providing that, "where there is no answer, the judgment shall not be more favorable to the plaintiff than that demanded in the complaint," was intended for protection of defendants who suffer default: it cannot be invoked in an attack upon the judgment by one not interested in the action. Where, therefore, an action is brought by a trustee for bondholders to foreclose a railroad mortgage, the amount of outstanding bonds is stated at a less amount than that found by the referee to whom it was referred to compute the amount due, that provision is not available to a bondholder moving to set aside the judgment entered or the report and a sale thereunder. Peck *v.* New York & New Jersey R. Co. (1881), 85 N. Y. 246; s. c. 7 Am. & Eng. R. R. Cas. 422.

A committee of bondholders, representing the proper amount in value of the bonds by the terms of a railroad mortgage, requested their trustee to institute a suit for foreclosure for the unpaid and past-due interest. They further declared they did not wish the principal declared due. The trustee filed such a bill. Months afterwards there were further defaults at interest periods, and under the mortgage provisions the trustee amended his bill and elected to declare the principal of the bonds due, and in the amended bill prayed foreclosure for the whole amount. The election of the trustee to declare the whole sum due was never objected to by any one, and the company answered the bill.

The court, while stating that this last proceeding would have been properly by

a chancellor must, in passing upon the claims of the bondholders of various classes, necessarily decide in what order those claims shall be paid, the validity of the decree cannot be questioned on the ground that the holders of the bonds of one of those classes asserted their right of priority in *ex parte* proceedings, and that the chancellor acted upon the application without notice to the other bondholders.[1]

The prayer for "such other and further relief" is quite liberally construed in this connection. For example, although the remedy asked for specifically is strict foreclosure, the court is justified by such a prayer in entering a decree which goes to the length of a complete execution of the trust, and provides for a reorganization of the company.[2]

The right to object to a decree on the ground of its want of conformity to the bill may be lost by a want of promptitude in excepting to the propriety of the court's action in the proceedings leading up to the decree. Thus the owner of second consolidated bonds filed a bill for foreclosure and the appointment of a receiver. The court appointed a receiver, required all lienholders to come into the cause, and enjoined them from asserting their claims in any other case. All the lien-claimants filed cross-bills, asking affirmative relief and the sale of the property. For nearly three years the court dealt with the suit as a consolidated case, and finally decreed a sale free from all liens. It was held to be then too late to object to the decree, on the ground that it was not in conformity with the bill, or that, because the

a supplemental bill, still, under various circumstances here, and conduct of the parties, it was proper under this amended bill to decree the whole amount due, and also that a decree for a deficiency judgment was proper under the 92d rule of equity of the equity courts of the United States, though there was no special prayer for it. There was also a stipulation in this case as to what the mortgage covered. It was held that, after such stipulation, there could be made no objection to the inclusion of any of the property mentioned in the stipulation being included in the decree of foreclosure. Seattle, Lake Shore, & Eastern Ry. Co. *v.* Union Trust Co. (1897), 79 Fed. Rep. 179.

[1] Colt *v.* Barnes (1879), 64 Ala. 108; s. c. 7 Am. & Eng. R. R. Cas. 129.

[2] Sage *v.* Central Railroad Co. (1878), 99 U. S. 334, 341.

"It is true," the court said, "the bill contained no specific prayer for such directions; but beyond the relief specifically asked, the complainants prayed for such other and further relief as the nature of the case should require, and as might seem meet to the court. The specific relief sought was a strict foreclosure; but under the prayer for general relief it is not questioned that the decree for a sale was appropriate. And as the deed of trust was made a part of the bill, and provided what should be done in case the trustee became the purchaser at the sale, it does not appear to be going outside of the case to enforce the agreement contained in the deed into which the railroad company, the trustee, and, through the trustee, all the bondholders, had entered."

lienors had filed cross-bills, instead of obtaining leave to file original bills, the proceedings were irregular.[1]

§ 746. **Conformity of Decree to Mandate of Appellate Court.** — A mandate from the federal Supreme Court to a Circuit Court, which in substance directs the latter to ascertain the amount of moneys in the hands of the receiver, and apply it to the payment of the interest, and also, in the event of there being a deficiency after such application, to fix a date at which it must be paid or the property sold to satisfy it, does not mean that the rendition of the decree shall be postponed until the receiver's accounts are settled. Such a mandate has reference to the sum actually in the receiver's hands, which is properly applicable to the payment of the complainants' debt, and not to what, as it might appear upon a full investigation, ought to be available for that purpose.[2]

§ 747. **Provisions of Ordinary Decree of Foreclosure.** — A decree of foreclosure and sale must declare the fact, nature, and extent of the default which constituted the breach of the condition of the mortgage, and which justified the complainant in filing the bill for foreclosure; also the amount due on account of the default, which, with any further sums subsequently accruing and becoming due according to the terms of the security, the mortgagor is required to pay within a reasonable time, to be fixed by the court, and a direction that the property be sold if the sum thus fixed is not paid within the appointed time.[3]

[1] Bound *v.* South Carolina Ry. Co. (1893), 58 Fed. Rep. 473; s. c. 7 C. C. A. 322.

[2] Milwaukee & Minnesota R. Co. *v.* Soutter (1875), 2 Wall. 510.

[3] Chicago, Vincennes, & Danville R. Co. *v.* Fosdick (1883), 106 U. S. 47, 70; s. c. 12 Am. & Eng. R. R. Cas. 367, referring to the following passage from the opinion in Howell *v.* Western Railroad Co. (1876), 94 U. S. 463, as containing an authoritative statement of the practice to be followed in cases where a bondholder is foreclosing for unpaid interest.

"The plaintiff is entitled to a decree *nisi* for the amount overdue and unpaid, — a decree which will ascertain the sum so due, and give the company a reasonable time to pay it, say ninety days or six months, or until the next term of the court, at the discretion of that court. If this sum is not paid, the court must then order a sale of the mortgaged property, with a foreclosure of all rights subordinate to the mortgage, with directions to bring the purchase-money into court. If the case proceeds thus far, the plaintiff will have a lien on the money thus paid into court, not only for his overdue coupons, but for his principal debt, and it must be provided for in the order distributing the proceeds of the sale. If, however, the company shall pay the sum found due in the decree *nisi*, no further proceeding can be had until another default of interest or of the principal."

Under the English practice a declaration of charge of mortgage debentures issued by a corporation upon the corporate property is a proper preface to a judgment for sale of the assets at the instance of a debenture-holder: Parkinson *v.* Wainright (1895), 64 L. J. Ch. N. S. 493; but court cannot declare priorities: Brinsley *v.* Lyn-

The rule that the amount unpaid should be stated is applicable whether the principal is due or not.[1]

In a suit on a general mortgage, the decree can only be framed with reference to the interest unpaid thereon, where the divisional mortgagees are not parties to the proceedings.[2]

A provision that the purchaser shall be put in possession of the property, though not usual, does not vitiate a foreclosure decree. It simply anticipates what must be done after the sale.[3]

A decree which includes the amount of the principal, when it is not due according to the terms of the mortgage, is erroneous, and will be opened.[4]

To give a trustee judgment for the money found to be due in a foreclosure suit has been held to be erroneous, the proper course being for the court to retain control over it for the benefit of those who are entitled to it.[5]

The decree can embrace only those who are parties to the suit. Hence the decree foreclosing a general mortgage cannot include any provisions as to the unpaid interest on the divisional bonds, where the holders are not before the court.[6]

Where a corporate mortgage has been foreclosed in a court of equity, and a sale of the property decreed and made, if upon an appeal the decree of sale is declared null, on a motion to have the purchaser restore the property to the defendants, it is in the power of the court to impose a condition upon the parties that they pay into court the amount which had been paid in cash by the purchasers under the decree of sale, to be disbursed for costs, etc., before the property be restored to them. And, if they fail to make the payment, the court may decree a resale of the property, and reserve the adjudication of the conflicting rights until the sale has been made.[7]

ton, etc. Co. (1895), 13 Rep. 369. See also Marwick *v.* Thurlow (1895), 13 Rep. 481. On judgment directing moneys in court or hands of receiver to be applied on account of amount due, see Cumming *v.* Metcalfe's London Hydro, Limited (1895), 13 Rep. 501.

1 Grape Creek Coal Co. *v.* Farmers' Loan & Trust Co. (1894), 63 Fed. Rep. 891; s. c. 12 C. C. A. 350.

2 Union Trust Co. *v.* St. Louis, Iron Mountain, & Southern R. Co. (1878), 5 Dill. 1.

3 Vicksburg & Meridian R. Co. *v.* McCutchen (1876), 52 Miss. 645.

4 Ohio Central R. Co. *v.* Central Trust Co. of New York (1890), 133 U. S. 83; s. c. 10 Sup. Ct. Rep. 235.

5 Bardstown & Louisville R. Co. *v.* Metcalfe (1862), 4 Met. (Ky.) 199.

6 Union Trust Co. *v.* St. Louis, Iron Mountain, & Southern R. Co. (1878), 5 Dill. 1.

7 Alabama & Ga. Manuf. Co. *et al.* *v.* Robinson, 72 Fed. Rep. 708; s. c. 19 C. C. A. 152 (1896), affirming Same *v.* Same, 67 Fed. Rep. 190.

§ 748. **Judgment for Deficiency.** — In the absence of some provision in the mortgage accelerating the maturity of the bonds, in the event of a default in the payment of interest, a personal judgment for the balance of the principal of the mortgage debt remaining after the proceeds of a sale in foreclosure proceedings instituted on the ground of such a default cannot be made; for this would be equivalent to ordering the defendant to pay an indebtedness which is not yet due.[1]

§ 749. **Provisions of Decree foreclosing Mortgage on Road in Possession of Junior Mortgagee.** — Where a first mortgage is being foreclosed on a railroad in possession of a second mortgagee, whom it is proposed to hold to account for the earnings of the property managed by him, the decree should be that the account be first taken and stated; that a reasonable time should be given for the redemption from the sale under the second mortgage, and for the payment of such balance as should be found due on the first-mortgage debt, after deducting the net earnings of the property; and that, in default of such redemption and payment, the property be sold in satisfaction of the first-mortgage debt.[2]

§ 750. **Provision of Decree directing Sale subject to Liens.** — In the common case of the foreclosure of a junior mortgage, it must

[1] Ohio Central Ry. Co. *v.* Central Trust Co. of New York (1890), 133 U. S. 83; s. c. 10 Sup. Ct. Rep. 235 (see the extract from the opinion quoted in the note to § 745, above). s. p. Farmers' Loan & Trust Co. *v.* Grape Creek Coal Co. (1894), 65 Fed. Rep. 717; s. c. 13 C. C. A. 87.

In Jesup *v.* City Bank of Racine (1861), 14 Wis. 331, it was held, that, after the repeal of the statute authorizing the joinder of the legal cause of action on the bond or note, such a joinder was not permissible, unless both causes of action affected all the parties, according to the provisions of the Code on that subject; and that, as a result of this doctrine, no personal judgment for the deficiency could be taken in a suit in which some of the parties are brought in as subsequent incumbrancers merely, and therefore cannot be affected by that cause of action which seeks for a personal judgment against the mortgagor. See Seattle, Lake Shore, & Eastern Ry. Co. *v.* Union Trust Co. (1897), 79 Fed. Rep. 179, where a decree for deficiency was held allowable under the 92d rule in equity of the courts of equity of the United States. The owners of a certain amount of a fixed issue of debentures of a company brought an action in behalf of himself and the other holders of that issue, and asked a personal judgment that might reach other property of the company not embraced in the security. The court declined to do this, but declared that the holders of the whole issue of debentures were entitled to stand in the position of judgment creditors for the amount, and appointed a receiver for the property seizable by a judgment creditor. Hope *v.* Croydon & Norwood Tramways Co. (1887), 34 Ch. Div. 730. Compare Bowen *v.* Breem Ry. Co., 3 Eq. 541; Furness *v.* Caterham Ry. Co., 27 Beav. 358; *In re* Uruguay Central & Hyguersitas Ry. Co. of Monte Video (1879), 11 Ch. Div. 372.

[2] Racine & Mississippi R. Co. *v.* Farmers' Loan & Trust Co. (1868), 49 Ill. 331.

direct the sale to be made subject to the burden of the prior incumbrances.[1]

And as a prior incumbrancer ought not to be deprived of the right of bidding for the property up to the amount of his claim, his right of priority, if in dispute, ought to be settled before the sale.[2]

Where the railroad is ordered to be sold subject to the burden of the underlying mortgages, the decree may properly state that all the parties to such mortgages may proceed to foreclose them in the proper tribunals, if they so desire. Under such circumstances the amounts due on such mortgages may be given, but it is usual and proper to include in the decree some proviso to the effect that the "statements therein of the amount of bonds outstanding, or of interest or rental, paid or unpaid, on any of the mortgages shall not be taken as adjudicating or determining the matters so stated, and that the amounts are stated only for the purpose of enabling the parties who may desire to purchase the property to determine approximately the amount of prior liens or other charges upon that property and each part thereof."[3]

If the property has been placed in the hands of a receiver pending the litigation, and certificates issued by him, the decree may properly provide that the purchasers shall take the property subject to the duty of paying off the debts evidenced by such cirtificates, as well as any other debts which may have been created by the court, and that the receivers shall remain in possession of the property until such time as a payment shall be made of these obligations, or adequate security furnished for such payment.[4]

In such a case the receiver may also be required to file a detailed statement of his outstanding obligations, so that their amount may be known with sufficient certainty to enable purchasers to bid with confidence.[5]

§ 751. **Provision of Decree directing Sale before Settlement of Controversies regarding the Final Disposition of Assets.** — The common

[1] Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1886), 29 Fed. Rep. 618, 621.

[2] Campbell *v.* Texas & New Orleans R. Co. (1872), 2 Woods, 263.

For a discussion by a divided court as to the proper remedy by which to enforce a lien upon a portion of a railroad reserved in a saving clause of s decree, see Compton *v.* Jesup (1895), 68 Fed. Rep. 263. Also (1897), 167 U. S. 1.

[3] Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1887), 30 Fed. Rep. 332, 336.

[4] Central Trust Co. *v.* Wabash, St. Louis, & Pac. R. Co. (1886), 29 Fed. Rep. 618, 621.

[5] Bound *v.* South Carolina R. Co. (1893), 58 Fed. Rep. 473; s. c. 7 C. C. A. 322.

practice of the courts in regard to sales under trust mortgages is to require that, if there are prior liens, either contested or doubtful, or not precisely ascertained, such liens shall be ascertained, so that they may be made known to the purchaser, for otherwise he can have no knowledge of what he is buying.[1]

If some of the liens are alleged to be prior, and others subsequent, to the trust deed, this same necessity of making known to the purchasers which of them are prior, and which are subsequent, demands that their relative rank shall ordinarily be ascertained before the sale.[2]

An interlocutory order for an immediate sale upon terms discharging the lien of a mortgage not yet due will never be made, unless it clearly appears that in the end there must not only be a sale, but a sale on those terms.[3]

But although the courts will usually proceed on the principle that all disputed questions should be settled before the sale, so as to obviate the danger of deterring bidders, and thus sacrificing the property, this rule is subject to the reasonable qualification that wherever it is apparently in the interest of the parties that there should be a speedy sale of the property, the court may properly decree that the whole property be sold free from all incumbrances, whether mortgages, receiver's certificates, costs, expenses, etc., and that all disputes and controversies between the trustees of the various mortgages, and all questions regarding the amount due to the bondholders, be reserved for future consideration and determination, unaffected by anything in the decree.[4]

[1] Washington, Alexandria, & Georgetown R. Co. *v.* Alexandria & Washington R. Co. (1870), 19 Gratt. (Va.) 592.

[2] Ibid.

[3] Pennsylvania R. Co. *v.* Allegheny Valley R. Co. (1890), 42 Fed. Rep. 82, distinguishing First Nat. Bank of Cleveland *v.* Shedd (1886), 121 U. S. 74.

[4] First Nat. Bank of Cleveland *v.* Shedd (1886), 121 U. S. 74.

In Tome *v.* King (1891), 64 Md. 166; s. c. 21 Atl. Rep. 279, it is stated that among the orders made by the lower court was one directing the sale, free of all incumbrances, at the instance of the trustee of a second mortgage, upon a representation that the state of the property was such as to render it wholly unproductive, and that a sale thereof was called for in the interest of all parties.

In Middleton *v.* New Jersey West Line R. Co. (1874), 25 N. J. Eq. 306, a sale free from incumbrances, ordered by virtue of a statute, was objected to by the mortgagees in a mortgage on one part of the property, on the ground that they were unable to protect their interest thereunder, and by the mortgagees in a mortgage on another part of the property on the ground that it would deprive them of a portion of their remedy for the security and collection of their debt, and was therefore unconstitutional. The Chancellor, in view of the fact that an appeal would, in any case, be taken, declined to express an opinion on those points, and made an order *pro forma*, based on the theory that the objection of the former mortgagees was well founded, and that the objections of the latter were not sustainable. The first part of this order

The mere fact that some of the creditors might, by acquiring a knowledge of the precise interest they have in the proceeds, be placed in a more advantageous position for participating as bidders in the sale will not justify a delay which will prejudice the estate.[1]

The result of a sale free from incumbrances is that the purchasers, as a condition of receiving a complete title, are only required to pay the amount bid.[2]

A decree ordering a sale free from incumbrances, and reserving to the parties the right to redeem in the ordinary manner, upon paying the several amounts found due on the various claims against the defendant, will not be raised at the instance of a portion of the lienors, who seek to have the sale made subject to all incumbrances prior to the mortgage foreclosed, and all arrears of interest on those incumbrances paid from the proceeds, where the petitioners make no offer to bid an amount sufficient to pay those arrears, or any of the costs and expenses of the suit.[3]

When the threatened delay in the determination of validity of claims affects only a portion of them, the court will sometimes order the purchaser to pay enough to meet all claims then definitely ascertained, and that the property be subject to those afterwards settled.[4]

does not seem to have been appealed against, and the validity of the scheme was tested in the higher court, not with reference to its constitutionality, but to the first question, whether the statute authorized a sale free from incumbrances in the given case. This statute allowed such a sale, provided (1) "the legality of the mortgage or other lien was brought into question," and (2) "the property was of a character to deterioriate materially pending the litigation." The counsel for the mortgagees sought to confine the operation of the first clause to cases in which legal objections were raised as to the validity of the mortgage itself; but the court held this construction was altogether too narrow, and that the remedy was intended to take effect wherever there was any litigation between incumbrances respecting the validity, extent, or priority of their liens.

[1] Hand *v.* Savannah & Charleston R. Co. (1880), 13 S. C. 467; s. c. 12 Am. & Eng. R. R. Cas. 488.

[2] Swann *v.* Wright's Exrs. (1884), 110 U. S. 590, 598.

[3] Bound *v.* South Carolina Ry. Co. (1893), 58 Fed. Rep. 473.

[4] Turner *v.* Indianapolis, B. & W. R. Co. (1878), 8 Biss. 385. In this case the sale, instead of being made subject to such judgments, taxes, and leases, and a payment by the purchaser of such sum, in cash or certificates of the receiver, as should be necessary to pay that portion of the receiver's debts made in the operation of the main line of railroad, not theretofore directed to be assumed by the purchaser, with such other claims as should be allowed by the court on appeal to the Supreme Court, was made in pursuance of amendment to the decree in the lower court, to the effect that the sale should be made subject to the judgments for rights of way, to the taxes, to a certain lease made by the receiver, and also to certain debts which might be due from the receiver, as well as to such claims as might be allowed by the court on appeal to the Supreme Court of the United States. Judge Drummond said in regard to this change: "It was, so to speak, simply

The sole essential condition to the validity of an order requiring the payment of undisputed claims, and leaving for future ascertainment the interests of persons claiming admission to the several classes of creditors, is, that the debts paid have a clear priority over those remaining to be ascertained.[1]

In determining whether an immediate sale shall be ordered, the court will be governed largely, if not altogether, by the wishes of the parties interested.[2]

In other cases the sale will be ordered subject both to those liens which have already been established as superior in rank to that of the mortgage, and also to all liens of that character which may be established by references pending at the time of the decree.[3]

Unanimity among the bondholders is, of course, desirable in such a case; but if circumstances point strongly to the expediency of an immediate sale, and the largest part of the bondholders are in favor of it, the court will not hesitate to order it. A small minority of the bondholders cannot, against the wishes of the trustees and the rest of their co-bondholders, procure the postponement of the sale until all disputed questions as to the distribution of the proceeds are settled. Under such circumstances a representation by such minority that the "bidding will be deterred on account of the risk and uncertainty, and the property will be in great danger of being sacrificed," cannot be allowed to

changing the amount of money which was required to be bid for the property. Undoubtedly it would have been better, and much more satisfactory, if the court, before it had ordered a sale under the original decree, could have informed the parties who might purchase the property what was the precise amount of liens upon it. But that, in the nature of the case, was impossible, unless the sale of the property had been delayed until the final determination of these various claims by the Supreme Court of the United States, which might have involved the retention of the property by the court for several years. Therefore it was thought best by the court, and by the parties who are interested in the property, that it should be sold, and that the purchaser should pay enough to meet all the claims then definitely ascertained, and that the property should be subject to those adjudicated hereafter."

[1] Hand *v.* Savannah & Charleston R. Co. (1880), 13 S. C. 467; s. c. 12 Am. & Eng. R. R. Cas. 488.

[2] In Turner *v.* Indianapolis, B. & W. R. Co., *supra*, the action of the court was concurred in by all the parties in interest. In Middleton *v.* New Jersey West Line R. Co. (1874), 25 N. J. Eq. 306, a sale free from incumbrances was decreed at the instance of the receiver, although the bondholders had not expressed any formal wish to that effect, either individually or through the trustees, there being a strong impression on the Chancellor's mind that a large part of the bondholders were in favor of such action. In Randolph *v.* Larned (1876), 27 N. J. Eq. 557, the Court of Errors and Appeals reversed this order, on the ground that this impression was a wrong one

[3] Swan *v.* Wright's Exrs. (1884), 110 U. S. 590, 598. In this case the sale had originally been ordered free of incumbrances, and afterwards modified.

prevail against the opposing consideration that the financial condition of the company under the administration of the receiver is steadily growing worse.[1]

§ 752. **Decree preserving Lien of Unmatured Part of Debt.** — In a proper case a court of equity has the power so to mould its decree as to order a sale of mortgaged property to satisfy that part of the mortgage debt which is overdue, and preserve the lien on the mortgaged property in the hands of the purchaser as to the unmatured part of the debt. Thus where the P. company indorsed the bonds of the A. company, with a stipulation binding it to purchase at maturity the bond and each coupon at par, and providing that, when so purchased, each and all of said bonds and coupons are to be held by the said company, with all the rights thereby given, and with all the benefit of every security therefor, and the P. company, having been obliged to purchase coupons, filed a bill before the maturity of the bonds, it was held that the contract was to be so construed as to preserve to the bondholders their lien until the P. company should have fully performed its obligations according to the tenor of its indorsement, and that, in the meantime, its remedies upon purchased coupons must be kept within such limits as will effect that object. The court being of opinion that the original bill was framed upon the true theory of the equitable rights of the parties, decreed, in accordance with its prayer, that the sale should be made under and subject to the lien of the mortgage as to the principal of the bonds secured thereby, and the interest payable after the sale.[2]

§ 753. **Decree ordering Trustee to sell before Maturity of Bonds, though not authorized by Trust Deed.** — A trustee may be ordered to sell before maturity of bonds, though the mortgage does not in terms authorize a sale upon default in payment of interest, if that is the only way in which the security can be saved. A sale under such a mortgage has been held to have been properly decreed, where the evidence showed that the mortgagor was insolvent; that a subsequent purchaser of the road, under a junior incumbrance, would do nothing to discharge the interest; that the road, if operated by the trustee, would be run at a loss, and, if unused, would decay.[3]

§ 754. **Decree may find Amount due on Bonds, before Proof of same.** — A decree is not necessarily objectionable because it

[1] First Nat. Bank of Cleveland *v.* Shedd (1886), 121 U. S. 74.

[2] Pennsylvania R. Co. *v.* Allegheny Valley R. Co. (1891), 48 Fed. Rep. 139.

[3] McLane *v.* Placerville & Sacramento Valley R. Co. (1885), 66 Cal. 606; s. c. 26 Am. & Eng. R. R. Cas. 404.

undertakes to declare and find the amount due under each of the several mortgages foreclosed, before the bonds have been regularly produced and proved.[1]

§ 755. **Decree nisi may be rendered before Production of Bonds.** — In a suit to foreclose for default in the payment of interest, a decree *nisi* may be rendered although the bonds are not produced, nor the various claimants identified. At that stage of the action it is only necessary that the default and its amount should appear. If the decree of sale is made absolute, the holders of bonds can then be required to produce their bonds, and all questions of ownership and of the amount due to each claimant can be then determined.[2]

§ 756. **Allowance of Time for Payment of Amount found due.** — In a suit seeking foreclosure for interest, there should be a decree *nisi* for the amount due, and for sale of mortgaged property, in case such amount is not paid at the appointed time.[3]

Upon payment of the amount due, the decree will be suspended until default occurs in the payment of interest.[4]

The time allowed for payment is within the discretion of the court, but a period of four months is unreasonably short. If the length of period to be allowed for redemption before final sale is subject of an express enactment by a State, a federal court sitting in that State will be guided by the terms of that enactment, although the general rule is that such a court will follow the federal procedure in foreclosure suits wherever it is different from that of the State courts. The reason for thus qualifying the general rule is that the rights of the mortgagor cannot be adequately protected without allowing him the period for redemption which he is entitled to by the *lex loci contractus*.[5]

[1] Toler *v.* East Tennessee, V. & G. R. Co. (1894), 67 Fed. Rep. 168.

[2] Toler *v.* East Tenn., V. & G. R. Co. (1894), 67 Fed. Rep. 168, 181, citing Guaranty Trust & Safe Deposit Co. *v.* Green Cove Springs & M. R. Co. (1891), 139 U. S. 137, 150. The doctrine of the text was reaffirmed in Northern Trust Co. *et al. v.* Columbia Straw Paper Co. *et al.* (1896), 75 Fed. Rep. 936.

[3] Farmers' Loan & Trust Co. *v.* Chicago & A. Ry. Co. (1886), 27 Fed. Rep. 146; Chicago, Danvile, & Vincennes R. Co. *v.* Fosdick (1883), 106 U. S. 47, 70; Howell *v.* Western R. Co. (1876), 94 U. S. 463, from which a passage is quoted above. The decree in Blossom *v.* Railroad Co. (1865), 3 Wall. 196, provided that the mortgaged premises should be sold at public auction, unless the mortgagors should, prior to such sale, pay to the complainants the amount of the mortgage debt as specified in the decree.

[4] Farmers' Loan & Trust Co. *v.* Chicago & A. Ry. Co. (1886), 27 Fed. Rep. 146.

[5] Jackson & Sharp Co. *v.* Burlington & L. R. Co. (1887), 29 Fed. Rep. 474. There the court allowed the period of one year, which was provided by the laws of Vermont in all cases in which the security was not inadequate, and there were no other special reasons why the time should be shortened.

§ 757. **Provisions of Decree reserving Control of the Property.** — Provisions in decree of foreclosure and order confirming the sale, whereby the court retains authority to retake the property, and resell it for failure on the part of the purchaser to comply with the terms of sale, are intended as a reservation of jurisdiction over the property, to be exercised in the event of such non-compliance, and are not inserted to secure to that purchaser the right to complete the purchase or not, as he pleases.[1]

An order which would have the effect of setting aside the sale altogether is not warranted by the fact that the order confirming such sale contains the clause, "the right to any further order is reserved,"[2] or a clause reserving the power "to make further orders respecting the claims, rights, or interests in, or liens on, the property."[3]

§ 758. **Modifications of Decree, and what is a Final Decree.** — A decree which terminates the litigation between the parties on the merits of a case is a final decree.[4]

A final decree cannot be vacated, altered, or modified after the close of the term at which it was rendered.[5]

A decree of sale in a foreclosure suit, which settles all the rights of the parties, and leaves nothing to be done but to make the sale and pay out the proceeds, is a final decree.[6]

A decree of foreclosure and sale was entered in railroad

[1] Atkins *v.* Wabash, St. Louis, & Pac. Ry. Co. (1886), 29 Fed. Rep. 161, 170.

[2] Wetmore *v.* St. Paul R. Co. (1880), 3 Fed. Rep. 177, 180. Mr. Justice Miller said: "The language of that order differs but little from the ordinary language made use of in decrees, to the effect that 'further orders may be made upon a footing of this decree;' and I cannot believe that when it was made it was in the contemplation of the court who was confirming this sale that the 'further order' there spoken of was such an order as would set aside the sale. That was the thing they were passing upon." Further on he continues: "It is much more in conformity with reason, with precedent, and common sense, to believe that the 'further orders' referred to here are such orders as might be necessary for the distribution of the funds, as between the parties and the payment of the bonds which had to come in, and which might be disputed as to their ownership — probably for the delivery of the possession, for I do not see anything in this decree which requires the delivery of the possession, — probably for the making of a deed, (for I do not see anything here about the making of a deed). There are fifty things you can imagine which would be consistent with the confirmation of the sale, and which might yet require further orders of the court."

[3] Farmers' Loan & Trust Co. *v.* Newman (1888), 127 U. S. 649; s. c. 8 Sup. Ct. Rep. 1364.

[4] Bostwick *v.* Brinckerhoff (1882), 106 U. S. 3; s. c. 1 Sup. Ct. Rep. 15.

[5] Bronson *v.* Schulten (1881), 104 U. S. 410; Williams *v.* Morgan (1884), 111 U. S. 684; s. c. 4 Sup. Ct. Rep. 638; Central Trust Co. *v.* Grant Locomotive Works (1890), 135 U. S. 207, 224; s. c. 10 Sup. Ct. Rep. 736.

[6] Grant *v.* Phœnix Insurance Co. (1882), 106 U. S. 429; s. c. 1 Sup. Ct. Rep. 414; Green *v.* Fisk (1880), 103 U. S. 518; Railroad Company *v.* Swasey (1874), 23 Wall. 405.

foreclosure proceedings, with a reference to the master to ascertain and report the amount of the mortgage indebtedness, the proper allowances to be made as compensation to and for expenses of the receiver, the amount of outstanding receivers' certificates, and proper allowances to the trustee and its solicitors. The master reporting, a decree was entered confirming his report, though no sale had then been made. This latter decree, taken in connection with and aided by the former, was held to have terminated the litigation on the merits, fixed the rights of the parties, and that consequently it was a final decree, and was not subject to alteration or modification after the close of the term.[1]

After the expiration of the term in which a final decree is entered, the court cannot change its essential parts.[2]

But this rule does not apply to an interlocutory decree, such as one allowing petitioning bondholders to come in and participate in the undisturbed residuum of a fund. Such a decree may be altered or vacated at any time, with or without a motion for that purpose.[3]

On the other hand, even a final decree may be amended after the end of the term, as to the mode of its execution, manner of sale, time of publication of such sale, and distribution of proceeds arising therefrom. Thus a decree which provides that purchasers shall pay enough in money to liquidate certain judgments, taxes, and other claims, if they shall be allowed, may be amended during a subsequent term by providing that the property shall be sold subject to the judgments, taxes, claims, etc., in the hands of purchasers.[4]

A decree in which the property to be sold, and method of sale, are stated, and rights of parties determined, will not be altered on eve of sale, long after it has been filed, at instance of an applicant who alleges a difficulty in understanding its terms, no party to the suit having previously objected to it.[5]

[1] Petersburg Sav. & Ins. Co. *et al.* v. Dellatorre *et al.* (1895), 70 Fed. Rep. 643.

As to modification of decrees in foreclosure suit, see Farmers' Loan & Trust Co. *et al.* v. Oregon Pac. R. Co. *et al.* (Oregon, 1895), 40 Pac. Rep. 1089.

[2] Turner *v.* Indianapolis, B. & W. Ry. Co. (1878), 8 Biss. 380.

[3] Pinkard *v.* Allen's Admr. (1883), 75 Ala. 73. There the decree in question had been made in vacation, without notice to, and without the consent of, adverse parties, and was held to have been properly vacated, although the first two days of the ensuing term, the period within which applications for the vacation of decrees were required to be made under the rules of court, had already expired.

[4] Turner *v.* Indianapolis, B. & W. Ry. Co. (1878), 8 Biss. 380.

[5] Duncan *v.* Atlantic, Mississippi, & Ohio Ry. Co. (1882), 4 Hughes, 125, 131. "If," said the court, "there is any

Article II. — Effect of Decree.

§ 759. **Effect of Foreclosure Decree generally.** — In the absence of any statute to the contrary, the foreclosure cuts off all rights and interests of mortgagor in mortgaged property, and nothing is left for general creditors and stockholders save their interests in the surplus after mortgage is satisfied.[1]

This result is not affected by the fact that the purchase is made in pursuance of a plan of reorganization authorized by statute. Such a plan has reference only to the new corporation.[2]

"Where there is a fund in court to be distributed among a class of creditors, a decree of distribution which seems to make no provision for some of the class will not ordinarily preclude any of the class having rights similar to those of other claimants from asserting, by bill or petition, their rights to a share in the fund."[3]

§ 760. **Conclusiveness of Decree.** — It may be said in general that a judgment or decree affirming the existence of any fact is conclusive upon parties or their privies, whenever the existence of such fact is again in issue between them.

Hence if a court of competent jurisdiction, after full hearing as to validity of bonds, has pronounced them void, a bill to charge a successor corporation with such bonds will not be entertained by any other court;[4] provided the person who seeks to raise the same questions in a second suit was not prevented from raising them in the former suit by the wrongful act of the other party.[5]

Where the validity of a trust deed has been determined in the prior suit, that question cannot again be litigated between the same parties, although the allegations of the first bill are supported and fortified by other charges, where no reason is given why the supplementary allegations were not included in the former bill.[6]

A State court receiver in a stockholder's suit, and afterwards

difficulty created by its terms in the bidding, and it can be shown after the sale that bidders were hindered by any obscurity or harshness of its terms, the party suffering from that defect can come into court and object to the ratification of the sale on that ground."

[1] Vatable *et al.* *v.* New York, Lake Erie, & Western R. Co. (1884), 96 N. Y. 49; s. c. 17 Am. & Eng. R. R. Cas. 268.

[2] Ibid.

[3] Lurton, Circuit Judge, in Burke *v.* Shortt (1897), 79 Fed. Rep. 6, 8.

[4] Beals *v.* Illinois, M. & T. R. Co. (1886), 27 Fed. Rep. 721.

[5] Brooks & Hardy *v.* O'Hara Bros. (1881), 8 Fed. Rep. 529.

[6] State *v.* Brown (1885), 64 Md. 199; s. c. 1 Atl. Rep. 54; 6 Atl. Rep. 172; 24 Am. & Eng. R. R. Cas. 192.

in a bondholder's suit, who, upon removal of latter suit to federal court, pays in the amount found due upon an accounting, and has his compensation fixed at the same time, the judgment rendered on the appeal of the whole case is conclusive as to the point that the liability of the fund to him has been fully disccharged; and he cannot make good a claim for additional compensation by reinstating the stockholder's suit on the docket of the State court, and procuring an order from that court granting him a further allowance.[1]

The principle of *res judicata* also extends to the grounds of defence or recovery which might have been, but were not, presented in former suit.[2]

A foreclosure decree which adjudges that defendants named, including one who holds a mortgage prior in date, but distinctly alleged in the bill to constitute a subordinate lien, shall be barred and foreclosed, etc., determines the question of priority raised, although it does not expressly state that such defendant's mortgage is inferior to one in suit.[3]

So a prayer that the mortgage be decreed a first lien on the road and franchises, coupled with the joinder of certain contractors as defendants, and an allegation that they set up claims against the road, which complainant does not admit to be of any validity against his mortgage, constitute sufficient grounds for a decree to sell the mortgaged property, discharged of all liens, the result being that the contractor's claim is thereby concluded.[4]

Although claim of a creditor for services is paramount under a statutory provision to the mortgage, yet if creditor is made a party to a foreclosure in which the validity of his claim is denied, and after appearance suffers the bill to be taken *pro confesso*, he will be estopped from asserting a lien upon property in hands of purchaser, under a decree that the sale shall convey title discharged of all liens and claims. The rights of the creditor are not strengthened in such a case by the fact that he

[1] *In re* Hinckley (1880), 3 Fed. Rep. 556; s. c. *sub. nom.* Hinckley *v.* Morton (1881), 103 U. S. 764.

[2] Beloit *v.* Morgan (1868), 7 Wall. 619, 622; State *v.* Brown (1885), 64 Md. 199; s. c. 1 Atl. Rep. 54; 6 Atl. Rep. 172; 24 Am. & Eng. R. R. Cas. 192; Bell *v.* Chicago, St. Louis, & N. O. R. Co. (1882), 34 La Ann. 785.

A decree rendered in the United States Circuit Court for one district in an action between the same parties is not *res adjudicata* as to an action in another district. Compton *v.* Jesup (1897), 167 U. S. 1.

[3] Board of Supervisors *v.* Mineral Point R. Co. (1869), 24 Wis. 93.

[4] Woods & McBrown *v.* Pittsburg, Cincinnati, & St. Louis Ry. Co. (1881), 99 Pa. St. 101; s. c. 7 Am. & Eng. R. R. Cas. 478.

reduced his claim to judgment before bill was filed in foreclosure.[1]

A bondholder is bound by decree giving priority to a levy as against the mortgage when he does not show, in presenting his claim, whether it arose before or after such levy.[2]

On the other hand, claims which are neither expressly passed upon by the decree, nor of such a character that their settlement is necessarily involved in the decision actually rendered, are not concluded by a decree of sale which virtually ignores the pleadings in which the claims are presented, and contains no reference to them, except an order that the portion of the complainants' bill relating to those claims is to be consolidated with the causes pending in the court against the same respondents, and a provision reserving for the future consideration of the court so much of the complainants' demand as asserts a first lien upon certain specific personal property.[3]

[1] Woods & McBrown *v.* Pittsburg, Cincinnati, & St. Louis Ry. Co. (1881), 99 Pa. St. 101; s. c. 7 Am. & Eng. R. R. Cas. 478.

Chief Justice Sharswood said: "The principal contention of the plaintiff has been that there was no prayer in the bill that the road should be sold clear of all incumbrances. If, then, contractors had come and established their claim, no auch decree could have been made. The sale would have been necessarily subject to their claim. It might well be that the sale would not produce sufficient to pay them. The purchasers must then take *cum onere*. But no such contractors making defence, though summoned and appearing, the decree of sale could then properly be made, as it was, clear of all incumbrances. If all that the bill sought was to ascertain who were lienholders to be paid from the proceeds, they were unnecessary parties. This they knew very well; they have, or ought to have, known that they were made parties as having an interest in the road paramount to the mortgage. It is perfectly clear that the object, and sole object, in making them parties was to ascertain what claims the road would be subject to in the hands of the purchasers, so that bidders might know for what they were bidding. They appeared to the bill: they had the opportunity to prove their claim conclusively against purchasers. They did not avail themselves of it. When ruled to plead, answer, or demur, they suffered the bill to be taken *pro confesso* against them. What did this mean? Surely that they had no such interest in the road, as contractors, as would be set up against the mortgage. They chose to take this course, and must adopt the consequences."

[2] McKee *et al. v.* Grand Rapids & Reed's Lake Street Ry. Co. (1829), 41 Mich. 274.

[3] Simmons *v.* Taylor (1885), 23 Fed. Rep. 849.

"In the consolidated suit," said Judge Brewer in the course of his opinion, "there was a decree barring the mortgagor's equity of redemption in default of the payment of the mortgaged sum within ten days after the decree, a finding of the amount due under the three first mortgages, an order requiring the payment of such sums within ten days, and an order for a general execution for any balance of such sums not realized upon the sales ordered, — in short, everything to show a foreclosure of those prior mortgages, and an omission of all of those matters in respect to this second mortgage. There was no finding, no orders, no decree of foreclosure against it as concerned this second mortgage. In fact, there was no other reference to it than in the simple reservation for future determination by

The rule to be applied in this and similar cases is that the language of the decree must be construed in reference to the issue which is put forward by the prayer for relief and other pleadings, and which these show it was meant to decide. Hence, though such language is very broad and emphatic, sufficiently so, perhaps, when taken in the abstract merely, to include the decision of questions between co-defendants, yet where the pleadings, including the prayer for relief, are not framed in the usual way in equity, when it is meant to bring the respective claims and rights of co-defendants before the court, but are framed as in a controversy between the complainant and defendant chiefly or only, such general language will be held down to these two principal parties alone.[1]

An action in which the validity of the bonds is put in question is not barred by a decree in a former action in which that question was not raised.[2]

Where the United States Circuit Court has acquired jurisdiction of foreclosures brought by trustees of principal mortgage, and afterwards consolidated with various suits for foreclosure of divisional mortgages brought by their several trustees, though the diverse citizenship of parties, under decree of foreclosure, has been made, a bill brought by stockholders of the defendant corporation in the same court to set aside the decree in the original consolidated cause, on allegations that it was obtained

the court of so much of its claim as asserted a first lien upon certain specific personal property. The decree, except as to a little matter of alleged priority in respect to some personal property, ignores the answer and cross-bill filed by the appointed trustee for this second mortgage." Counsel had taken the ground that there was such a difference between the old proceedings for strict foreclosure, and the ordinary proceedings at the present day for foreclosure by sale, that all the rights of all the parties to the suit are cut off by the sale. The learned judge pronounced this doctrine to be too broadly stated, saying: "I agree that every right presented and adjudicated for or against any mortgage or mortgagor is determined by the decree, but I cannot agree that a right presented by bill or cross-bill, and unnoticed in the decree, and not absolutely necessary for determination in the decree, is determined by the simple fact that the party presenting it is in court. The rights of the various parties to a foreclosure suit are determined by the nature of the decree entered. And nothing is determined which is not expressly determined, or which is not impliedly settled by the terms of the decree in fact entered."

[1] Graham *v.* Chamberlain (1866), 3 Wall. 704.

The owner of a judgment in the State court establishing a statutory lien upon railroad property, whose petition to be allowed the privilege of intervening in proceedings in the United States Circuit Court has been discussed without prejudice, will not be enjoined from enforcing his judgment, for the reason that the property has been sold under a decree of the United States court. Blair *v.* Walker (1886), 26 Fed. Rep. 73.

[2] City of Chicago *v.* Cameron (1887), 120 Ill. 447; s. c. 11 N. E. Rep. 899.

by collusion, fraud, etc., is an ancillary or auxiliary suit to the main one. If such bill be dismissed, and the complainants appeal from the order to the United States Circuit Court of Appeals, and this latter court make a decree affirming the decree of the Circuit Court, the decree of the Circuit Court of Appeals is a final decree, within the provisions of the sixth section of the act of March 3, 1891, and no appeal from it will lie to the Supreme Court.[1]

A bondholder will not be allowed to intervene to have the decree opened and himself allowed to make a defence after a decree of sale in a foreclosure suit, upon his allegations that he had first heard of the foreclosure suit after the advertisements of the sale were posted, where he has been directly contradicted by a witness, and the foreclosure is clearly shown to have been long a matter of general discussion in the neighborhood where the bondholder resided.[2]

§ 761. **Federal Courts bound by Decisions of State Courts respecting State Statutes.** — Where the Supreme Court of the State in which a federal court is held has decided that the foreclosure of a mortgage under the law of that State was *bona fide*, and in conformity with the State law, such judgment must be held as furnishing the rule of decision to the federal court, except, perhaps, as regards the question whether the State law is constitutional.[3]

§ 762. **Estoppel by Decree.**[4] — Persons made parties to a foreclosure suit, as subsequent incumbrancers, whose rights were already acquired, and existed at commencement of suit, are bound to set up their claims and assert their rights in that suit, on peril of being cut off and foreclosed, in respect to such claims.[5]

So far as regards the conclusiveness of the decree upon their rights, it is immaterial what their liens actually are. That they are brought in as judgment creditors, owing to the fact

[1] Carey *v.* Houston & Texas Central Ry. Co., 161 U. S. 115; s. c. 16 Sup. Ct. Rep. 537 (1896). See also Carey *v.* Houston & Texas Central Ry. Co. (1893), 150 U. S. 170, 180.

[2] Farmers' Loan & Trust Co. *v.* Rockaway Valley R. Co. *et al.* (1895), 69 Fed. Rep. 9.

[3] Sullivan *v.* Portland & Kennebec R. Co. (1874), 4 Cliff. 212.

[4] The extent to which bondholders are bound by a decree rendered in a suit in which they are represented by a trustee is discussed in another chapter.

[5] Benjamin *v.* Elmira, Jefferson, & Canandaigua R. Co. (1867), 49 Barb. 441. In this case a decree declaring a mortgage of after-acquired property to be a valid lien thereon was held to conclude the plaintiffs, who had a chattel mortgage on a part of the same property, but who, although made parties to the suit, failed to litigate the question of the relative rank of the two liens.

that the plaintiff does not know that they hold a chattel mortgage on the property, is, in this point of view, of no consequence.[1]

A company purchasing the mortgaged property at a foreclosure sale, subject to the lien of a mortgage of indemnity given by the vendor company to secure a county for the loan of its bonds, cannot question the validity of those bonds, when the county itself has already raised that point by a cross-bill filed in a creditor's suit against the vendor company, and that cross-bill has been dismissed by a decree absolute in its terms.[2]

The transferee of the purchaser at the sale will not be allowed to reopen an inquiry as to a claim which was pending at the time decree was made, where sale is expressly made subject to all liens of certain classes, among which is the claim in question, and the purchaser made no suggestion before the confirmation of the sale that he bought the property in ignorance of the existence of these claims, or that the court should reserve the right to establish them as liens superior to the mortgage; and neither raised an objection that they had been allowed for larger amounts than those originally contended for, nor asked that, in view of their allowance, he be permitted to surrender his purchase, so that the property might be resold for the benefit primarily of those having first liens.[3]

A suit brought for general benefit of all stockholders, as, for example, to stay a foreclosure sale on ground that trust deed is invalid, is binding upon all of them, and they cannot thereafter be heard to deny the right of the trustees to sell in accordance with terms of deed of trust.[4]

The unsecured creditors of a railroad company, although not parties to a foreclosure suit, are bound by adjudications rendered therein; as, for instance, by an order in which it is determined that certain stocks and bonds which are not in terms covered by the mortgage shall be held and dealt with by the receiver as part of the fund subject to the lien of such mortgage, and by a final decree in which it is determined that they shall be sold as part of the mortgaged property.[5]

But no one who holds a specific lien upon the corporate

[1] Benjamin *v.* Elmira, Jefferson, & Canandaigua R. Co. (1867), 49 Barb. 441.

[2] Washington, Ohio, & W. R. Co. *v.* Cazenove (1887), 83 Va. 744; s. c. 3 S. E. Rep. 433.

[3] Swann *v.* Wright's Admrs. (1884), 110 U. S. 590.

[4] State *v.* Brown (1885), 64 Md. 199; s. c. 1 Atl. Rep. 54; 6 Atl. Rep. 172; 24 Am. & Eng. R. R. Cas. 192.

[5] Herring *v.* New York, L. E. & W. R. Co. (1887), 105 N. Y. 340; s. c. 12 N. E. Rep. 763.

property is bound by decree rendered in a foreclosure to which he is not a party. Hence a decree declaring a mortgage a first lien upon that property will not give it precedence over a lien which is actually a prior one, held by one who has no notice of the proceedings, and is not privy to the decree.[1]

Similarly, as a decree does not conclude judgment creditors whose petition to be allowed to intervene has been dismissed, the latter will not, at the instance of the purchaser at the sale, enjoin the creditors from enforcing their judgment lien.[2]

Nor will a decree declaring a mortgage to be a first lien on the property affect the rights of a judgment creditor who had no notice of proceedings, and was neither a party nor privy to the decree. The existence of such a decree is, therefore, no defence to a *scire facias* to continue the lien against the company which has succeeded the original judgment debtor in the ownership of the road.[3]

§ 763. **Decree pro confesso.** — A decree taken *pro confesso* against lienholders upon their failure to plead is as binding upon them as if they had actually appeared and presented their case to the court.[4]

§ 764. **Decree by Consent.** — Parties to a suit have the right to agree to anything they please in reference to the subject-matter of their litigation, and the court, when applied to, will ordinarily give effect to their agreement, if it comes within the general scope of the case made by the pleadings. Thus it is in the power of the parties to a foreclosure suit to agree that a decree may be entered for a sale of the mortgaged property, without any specific finding of the amount due on account of the mortgage debt, or without giving a day of payment. It is also competent for them to agree that, if the property is bought at the sale by or for the bondholders, payment of the purchase-money may be made by a surrender of the bonds. Where the decree embodies agreements made by the parties as to such matters, it does not lie with them to complain of what the court has done to give effect to these agreements.[5]

A decree by a court of record, purporting upon its face to be

[1] Pittsburg, Cincinnati, & St. Louis Ry. Co. *v.* Marshall (1877), 85 Pa. St. 187.

[2] Blair *v.* Walker (1886), 26 Fed. Rep. 73.

[3] Stewart *v.* Wheeling & L. E. R. Co. (1895), 53 Ohio St. 151; s. c. 41 N. E. Rep. 247; Pittsburg, Cincinnati, & St. Louis Ry. Co. *v.* Marshall (1877), 85 Pa. St. 187. Compare Tyrone & Clearfield R. Co. *v.* Jones (1875), 79 Pa. St. 60.

[4] Woods & McBroom *v.* Pittsburg, Cincinnati, & St. Louis Ry. Co. (1881), 99 Pa. St. 101; s. c. 3 Am. & Eng. R. R. Cas. 525.

[5] Pacific Railroad *v.* Ketchum (1879), 101 U. S. 289, 297.

taken by consent of all parties to the record, has the verity of a record as to the recital of the consent, and is not to be controverted except for fraud, accident, or mistake, and then only in a proceeding directly to set it aside.[1]

This principle has been held to give validity to a decree which would otherwise have been objectionable as being in contravention of a statutory provision by virtue of which a court of chancery is deprived of its power of deciding disputed issues of fact without a jury. In Clews, etc. *v.* First Mortgage Bondholders,[2] ruled with reference to § 4206, Georgia Code of 1882, a receiver was appointed in a creditor's suit to marshal the assets of an insolvent railroad, and several claims, after being reported upon by a master, were considered either by a jury, or, where the parties so agreed, by the court sitting without a jury. Judgments upon these claims having been taken, fixing the amount and character of each lien upon the fund, a decree of sale was entered by the consent of all the parties, reserving the rights of certain creditors whose claims were still unsettled, and providing that the proceeds of the sale should be brought into court and distributed among the lienholders whose rights had been fixed. The property was sold, and at the next term the court made a final decree, holding up so much of the proceeds as was necessary to pay the claimants, whose rights had been reserved, and ordered the remainder to be distributed by commissioners according to the provisions of the consent decree. This final decree was held to have been properly made without the intervention of a jury, as it was merely a judgment carrying into effect, through ministerial officers, the previous decree taken by consent of the parties. Similarly a claim of a surety on an appeal bond, asserted to have priority over the mortgage, may be allowed, if assented to by all the parties concerned, though otherwise it would be rejected.[3]

A decree cannot be deemed to be one taken by consent, although the record shows the presence of the parties, and contains a recital that they consented to such decree, or submitted a decree which they desired to have entered, where, notwithstanding all this, the record goes on to state that the court did not enter that particular decree, but took the papers and entered a decree upon its own consideration.[4]

[1] Clews *v.* First Mortgage Bondholders (1874), 51 Ga. 131.

[2] 51 Ga. 131 (1874).

[3] Central Trust Co. *v.* Wabash, St. Louis, & Pac. Ry. Co. (1885), 24 Fed. Rep. 98.

[4] Wetmore *v.* St. Paul & Pac. R. Co., 3 Fed Rep. 177.

§ 765. **Acquiescence in Decree.** — It is a well-settled rule of law that, where an unauthorized sale of property is expressly or impliedly ratified by the owner, he is precluded from subsequently setting up his title against the purchaser. Acquiescence is an implied sanction of the sale. As in all other cases in which the aid of a court of chancery is asked, the petitioner who seeks to set aside a decree must act with reasonable promptitude in order to obtain relief. Judgments and decrees become binding by the acquiescence of the parties affected by them, especially when they have actually been executed and carried into effect.[1]

Thus, although stockholders who refuse to consent to a lease of the corporate property have a right to procure the annulment of a subsequent foreclosure sale, by which interests under this lease pass from the lessee to another company, yet even if the lease is *ultra vires* and tainted with fraud, they will be denied relief, where they take no steps to assert their rights for about ten years. The mere fact that, at the time the lease was made, the lessor's road was in the hands of trustees is not an excuse for such inactivity, for they still had a right to be heard before a court as to the permanent alienation of the property.[2]

If corporate officers fraudulently consent to a judgment or decree in a foreclosure suit, the stockholders may, perhaps, afterwards file a bill to set it aside, provided they do so within a reasonable time after discovery of the fraud. But if they have received notice that the officers were not faithfully defending that suit, and notwithstanding such notice neglected to intervene or take any steps in the way of endeavoring to do so, and permitted final judgment or decree to be entered, and sale to take place, they cannot, after the lapse of years, be allowed to attack the validity of the proceedings, and the corporation is in such a case equally estopped.[3]

Especially will relief be denied to a stockholder who neglects to move for such a long period as ten years, when no concealment is charged, and the facts relied on were well known to the officers of the company, and, if not actually known to the complainant himself, might have readily been ascertained by him during the progress of the foreclosure suit.[4]

[1] Vermont & Canada R. Co. *v.* Vermont Central R. Co. (1877), 50 Vt. 500; s. c. 14 Am. Ry. Rep. 497.

[2] Boston & Providence R. Corp. *v.* New York & New England R. Co. (1881), 13 R. I. 260; s. c. 2 Am. & Eng. R. R. Cas. 300.

[3] Pacific Railroad (of Missouri) *v.* Missouri Pacific Ry. Co. (1881), 2 McCrary, 227, 231.

[4] Foster *v.* Mansfield, C. & L. M. R. Co. (1888), 36 Fed. Rep. 627.

Nor can the stockholders procure the cancellation of a decree of foreclosure and sale rendered against the corporation, where they had knowledge, pending the suit, that the corporate officers were not acting in good faith, and delayed their application for relief for a period of four years, during which the decree has been fully executed, the property sold, the sale confirmed, and the property conveyed by the purchaser to a new corporation which has issued new stock, and placed negotiable bonds for large sums upon the market.[1]

Relief will be denied to one who, after exchanging his bonds for preferred stock, makes application for a rescission of the contract long after the property of the company has been sold by the trustees of the mortgage securing the bonds so exchanged, since such rescission would render it necessary to set aside the sale and the title acquired thereunder by the purchasers.[2]

One who claims the right of avoiding the purchase made by another at a judicial sale, or of holding the purchaser as a trustee, and availing himself of the purchaser's bid, cannot delay the assertion of this right for the purpose of being able to decide, in the light of subsequent events, whether it will be profitable or not to take action.[3]

§ 766. **Estoppel of Junior Lienor.** — A second mortgagee is not estopped from asserting that his rights are cut off by a foreclosure under a senior mortgage to which he is a party, merely because he remains silent when that foreclosure is consummated by a decree which does not bar his rights, nor file the amount due under his mortgage, nor make any order for the sale of the property to satisfy that mortgage. The mere fact that he is made a party casts no obligation upon him. He may remain silent, and, if no decree is taken against him, his rights remain as though he had not been made a party.[4]

A junior mortgagee has a right to redeem, and if he stands by while a sale in a foreclosure suit to which he was a party is made and confirmed, he must, in equity, be deemed to have waived his right.[5]

[1] Pacific Railroad (of Missouri) *v.* Missouri Pacific Ry. Co. (1881), 2 McCrary, 231.

[2] Coddington *v.* Railroad Co. (1886), 103 U. S. 409, 411. The dismissal of the bill was based both on the Statute of Limitation and the general doctrine of laches.

[3] Credit Co. *v.* Arkansas Central R. Co. (1882), 15 Fed. Rep. 46.

[4] Simmons *v.* Taylor (1885), 23 Fed. Rep. 849, per Brewer, J.

[5] Simmons *v.* Burlington, Cedar Rapids, & Northern Ry. Co., 159 U. S. 278 ; s. c. 16 Sup. Ct. Rep. 1 (1895), holding that a delay of seven years before attempting to enforce his alleged rights deprived a junior mortgagee of the right to ask the aid of a court of equity in enforcing them.

A junior mortgagee who is a party defendant to a foreclosure bill in which there is a prayer that he be decreed to redeem, and the priority of the plaintiff's mortgage is found or conceded, and a sale is ordered in default of payment, declaring the right of the mortgagee to redeem to be forever barred, a similar order as to right of redemption by the junior mortgagee is not substantially nor even formally necessary.[1]

[1] Simmons *v.* Burlington, Cedar Rapids, & Northern Ry. Co. (1895), 159 U. S. 278; s. c. 16 Sup. Ct. Rep. 1.

Mr. Justice Shiras, in the opinion, said: "We think the law was correctly stated by Mr. Justice Matthews in Chicago & Vincennes Railroad *v.* Fosdick, 106 U. S. 47, 68, where he said: 'In case the proceeding results finally in a sale of the mortgaged premises, the sale is made free from the equity of redemption of the mortgagor and all holders of junior incumbrances, if made parties to the suit, and is of the whole premises, when necessary to the payment of the amount due, or when the property is not properly divisible; it conveys a clear and absolute title as against all the parties to the suit, or their privies, and the proceeds of the sale are distributed after payment of the amount due, for non-payment of which the sale was ordered, in satisfaction of the unpaid debts remaining, whether due or not.'"

CHAPTER XXXIV.

DISTRIBUTION OF PROCEEDS OF FORECLOSURE SALE.

§ 767. **Introductory.** — Many of the principles by which the relative priorities of the various creditors of a mortgagor company are determined have necessarily been discussed in the preceding chapters, more especially in those relating to bonds, mortgages, and receiver's debts. In the present chapter it is proposed to collect the decisions which deal with the actual distribution of the fund, apart from any question as to the particular effect or validity of the transactions upon which the rights of the claimants are founded.

§ 768. **Master or other Person appointed to make Distribution is bound by Decree.** — The master or other officer to whom is assigned the duty of distributing the proceeds of the sale cannot go behind the decree to inquire whether the various claimants on the fund are entitled to a position different from that which they hold under the terms of such decree. Thus, he is bound by a

decree settling the relative priorities of mortgages on the property; and it is only a party affected by the decision who is entitled, upon an allegation of error, to ask for a review, or a rehearing, by the court.[1]

§ 769. **Lien Creditors, with some Exceptions, always preferred.** — A creditor who fails to establish any lien, legal or equitable, on the property is always postponed to those who hold such liens, the only exception to this rule being in cases where debts for operating expenses are, for some of the reasons explained in a previous chapter, charged upon the proceeds in preference to the specific liens. Thus, unless a judgment is by statute an actual prior lien on the property, it confers no priority as against a subsequent mortgage.[2]

Hence one who sells land to the company, agreeing to receive, as part of the consideration, second-mortgage bonds to be afterwards issued, and who, upon the bonds being tendered, refuses to receive them for the reason that certain judgments had been confessed by the company prior to the execution of the mortgage, has no lien, either equitable or legal, for the purchase-money for which the bonds were to have been delivered to him. The mere setting apart of the bonds gives him no claim for their amount in the distribution. After rejecting the bonds, he has no further claim on them. The company can then dispose of them as it pleases, and he has only a right of action against the company for the purchase-money.[3]

§ 770. **Holders of Equitable Debentures entitled to share pari passu with Legal Holders.** — Though debentures issued without the name of the obligee are void as legal instruments, one who lends money to the obligor and receives such blank debentures as collateral security is entitled to share in the benefit of the trust deed securing the debentures *pari passu* with the holders of complete debentures.[4]

§ 771. **Undisputed Prior Claims may be paid immediately.** — Claims having an undisputed priority may be paid without waiting to ascertain the extent of other interests in the fund.[5]

§ 772. **When Distribution is to be made according to Maxim "Equality is Equity."** — Each railroad bond, by the terms of the security, usually stands as an independent claim, entitled to its

[1] McElrath *v.* Pittsburg & Steubenville R. Co. (1871), 68 Pa. St. 37; s. c. 1 Am. Ry. Rep. 139.

[2] Fogg *v.* Blair (1890), 133 U. S. 534.

[3] Rice's Appeal (1875), 79 Pa. St. 168.

[4] *Re* Queensland, L. & C. Co. (1894), L. R. 3 Ch. 181.

[5] Hand *v.* Savannah & Charleston R. Co. (1880), 13 S. C. 467; s. c. 12 Am. & Eng. R. R. Cas. 488.

proper proportion of any fund which may be realized from the sales.[1]

What that proportion is will depend on the amount which remains for application to the particular class of securities to which any given bond belongs after prior claims have been satisfied. As between bondholders of the same class the principle prevails that "equality is equity."[2]

In such cases the principle regulating the distribution of money among execution creditors at law is not applicable.[3]

Where the trust deed provides that upon continuance of default in payment of interest for six months all the bonds shall become due, and trustees shall take possession and sell, and from the proceeds pay all such bonds, or so many as may be outstanding, the intention of the parties being thus shown to be that no sale shall be made except for the whole debt, the holders of bonds upon which interest has not been paid will have no priority, as to payment of such interest, over others upon whose bonds the interest has been paid.[4]

Where part of mortgage debt has been assigned, and the whole mortgage security is about to be appropriated to pay the debt, and is insufficient to pay the whole, it is usually distributed *pro rata*.[5]

§ 773. **Coupons usually payable pari passu with Bonds.** — In the absence of some special provision in the mortgage, coupons separated from the bonds to which they belong, and transferred to other holders, have no equity superior to that of the bonds themselves, or of subsequently maturing coupons. A railroad mortgage in the ordinary form stands as a security for the principal of the bonds as well as the interest, with no priority as to either. The coupons are mere representatives of the claim for interest, and the obligation of the debtor evidenced by them cannot be higher, or entitled to greater privileges, than it would be should the bonds in their body undertake the payment of interest.[6]

[1] Coe *v.* Columbus, Piqua, & Indianapolis R. Co. (1859), 10 Ohio St. 372, 410.

[2] Morton *v.* New Orleans & Selma R. Co. (1885), 79 Ala. 590; Rice's Appeal (1875), 79 Pa. St. 209; *In re* Regent's Canal Iron Works (1876), L. R. 3 Div. 43.

[3] Morton *v.* New Orleans & Selma R. Co. (1885), 79 Ala. 590, 621, citing Colebrooke on Collat. Sec., § 159; 1 Story Eq. Juris., §§ 554, 555.

[4] Humphreys *v.* Morton (1881), 100 Ill. 592.

[5] Sewall *v.* Brainerd (1865), 38 Vt. 364.

[6] Ketchum *v.* Duncan (1878), 96 U. S. 659, affirming Duncan *v.* Mobile & Ohio R. Co. (1877), 3 Woods, 567.

In this last case the mortgage required the trustees, in the event of a sale, to apply the residue of the proceeds, after deducting costs, etc., "to pay the principal and interest which may be due on the bonds issued." The court said that the plain meaning of this provision was that the bonds and interest due (that is, owing or contracted to be paid) were to share in the application.

This principle is sometimes embodied in the mortgage itself, as where it is provided that in case of default and sale, or other proceedings to enforce the bonds, "all bonds which shall then be a lien in common therewith, and the interest accrued thereon, shall be considered equally due and payable, and entitled to a *pro rata* dividend of the proceeds of said sale or other proceedings." The inference that overdue coupons are not entitled to any preference under such an instrument is not rebutted by the addition of a clause to the effect that "in no case shall the principal of any bond be considered due until twenty years from the date thereof." Such a clause merely means that a bondholder cannot, under any circumstances, bring an action for the principal before it becomes due by its terms.[1]

It has been held, however, that *where the fund is insufficient to pay the whole principal and interest*, unpaid coupons belonging to a class in which a part of the coupons has been already paid, should be paid before coupons falling due at a later date, and before the principal of any of the bonds; and that coupons detached, and in the hands of others than the holders of the bonds from which they were detached, should be paid before such bonds.[2] That case, however, does not decide that such a preference would have been just if the mortgage had contained no such provision, but merely that the provision was decisive against the correctness of the decree allowing the preference. It was, in fact, cited in Ketchum *v.* Duncan, *supra*, to support the rule that all coupons are on an equality *unless* the mortgage provides otherwise. Assuming such preference to be proper, there is no difficulty in accepting the secondary proposition laid down by the learned judge, that the diligence of some of the holders of the preferred class of coupons in demanding and receiving their interest could not be imputed as laches to those who failed to take action, so as to work a virtual preference in favor of the former (see p. 416 of the opinion). The priority being absolute, if the general doctrine be accepted, the right of the coupon-holder to insist on it clearly cannot be forfeited until the right of action itself on the debt is lost by lapse of time or otherwise. But it seems impossible to sustain the

[1] Dunham *v.* Cincinnati, Peru, etc. Ry. Co. (1863), 1 Wall. 254. Judge Blatchford in making this ruling appears to have assumed that past-due coupons might be paid in preference to the principal of the bonds and to later coupons, unless the mortgage provided for the *pro rata* payment, as in Dunham *v.* Cincinnati, Peru, etc. Ry. Co., *supra*, which was referred to by him, decided it should be noticed before Ketchum *v.* Duncan, *supra*.

[2] Stevens *v.* New York & Oswego Midland R. Co. (1876), 13 Blatch. 412.

main principle on which this decision rests, as it is quite irreconcilable with the decision of the Supreme Court of the United States in Ketchum *v.* Duncan, *supra.* In a case involving somewhat similar circumstances the Supreme Court of South Carolina has denied its correctness, holding that the fact of some of the coupons of a certain issue of bonds having been already paid in bonds guarantied by the State did not raise any equity for the payment of unsettled coupons of the same class and dates in preference to the bonds and later coupons.[1]

A decree of distribution of the proceeds of sale of railway property in payment of the principal of the bonds proportionally has been construed as intended to deal with the ownership of bonds and their coupons under the general designation of "bonds." Therefore, that coupons detached from such bonds and matured at the time of foreclosure, as the mortgage had given a preference to interest, were entitled to be paid in full, and those maturing after the decree, if detached, to share proportionately with the principal of the bonds.[2]

A water company had placed with a mortgage company, as collateral security, certain of its bonds with the coupons attached. After sale of its property in foreclosure proceedings, a bank, to which the water company had assigned these coupons, excepted to the report of a master disallowing the bank's claim to be paid the amount of these coupons from the proceeds of sale. The exceptions were overruled.[3]

§ 774. **Priorities between Bondholders and Lenders of Money to take up Coupons.** — (Compare Chapters II. and III., where the cases involving the question, whether bonds and coupons are bought or paid, are discussed.)

[1] Hand *v.* Savannah & Charleston R. Co. (1881), 17 S. C. 467; s. c. 12 Am. & Eng. R. R. Cas. 495. Yet it was recently remarked, *obiter*, by Judge Acheson, in Pennsylvania R. Co. *v.* Allegheny Valley R. Co. (1891), 48 Fed. Rep. 139, that a provision giving to the overdue coupons priority over the principal of the bonds in the distribution of the proceeds of the sale is the appropriation which the law itself makes when the fund is deficient; namely, to the discharge of accrued interest first, and then of principal. No authorities were cited, and it seems as if the decision of the Supreme Court to exactly the opposite effect must have been overlooked for the moment by the learned judge.

In Child *v.* New York & New England R. Co. (1880), 129 Mass. 170, the court said, *arguendo:* "It may be that if, upon foreclosure, the proceeds are not sufficient to pay both, it would be equitable that they should be divided *pro rata* between the holders of the bonds and coupons." The point not being directly involved, the remark is of no greater weight than any other cautious suggestion of a rule, but, as an *obiter dictum*, it goes to counteract the effect of the last case cited.

[2] Burke *v.* Shortt (1897), 79 Fed. Rep. 6.

[3] New York Security & Trust Co. *v.* Equitable Mortgage Co. (1896), 77 Fed. Rep. 64.

As against bondholders who presented their coupons for payment and not for sale, and who had the right to assume they were paid and extinguished, a person who advances the money to take them up under an undisclosed agreement with the company that the coupons should be delivered to him uncancelled, as security for his advances, is not entitled to an equal priority in the lien, or the proceeds of the mortgage by which the coupons are secured.[1]

To sustain the claim of an intervener to share in the proceeds upon coupons which he has paid to the holder, such payment must have been made upon a distinct understanding with the holders of the bonds to which such coupons belonged, that they were purchased and not discharged.[2]

Coupons received by one who advanced the money with which they were taken up, under an agreement that they were to be delivered to him uncancelled, as security for the advance, are valid securities in his hands, and he may enforce the mortgage against the company. But as between him and the bondholders who received the amount of their coupons in ignorance of the transaction, and supposing their coupons to have been paid, the latter have the prior equities; and if the sum realized from the sale is insufficient to pay the face of the bonds, the holder of the coupons is not entitled to share in the proceeds.[3]

§ 775. **Priorities of Persons surrendering Securities and thereby increasing the Corporate Assets.** — When title papers belonging to an insolvent railroad company which have been placed in the hands of a person to be held until certain amounts due to an attorney for legal services in procuring rights of way, and to another creditor for advances, and the assets are thereby increased, the debts for which those papers were held should be paid out of the proceeds of the sale next after the right of way claims.[4]

§ 776. **Priorities affected by Funding Interest.** — First-lien bondholders who avail themselves of the provisions of an interest-

[1] Cameron *v.* Tome (1886), 64 Md. 507; s. c. 2 Atl. Rep. 837; 2 Cent. Rep. 639, declaring the rule to be well settled to this effect by Union Trust Co. *v.* Monticello & Port Jervis R. Co. (1875), 63 N. Y. 311; Haven *v.* Grand Junction R. & Depot Co. (1871), 109 Mass. 88; Ketchum *v.* Duncan (1877), 96 U. S. 659, 662.

[2] Farmers' Loan & Trust Co. *v.* Oregon & Washington Territory R. Co. (1895), 67 Fed. Rep. 404.

[3] Union Trust Co. *v.* Monticello & Port Jervis R. Co. (1875), 63 N. Y. 311. Judge Earl said: "Equity will keep the securities in life in such cases to promote the ends of justice, but not against any person having a superior equity."

[4] McDonald *v.* Charleston, C. & C. R. Co. (1893), 93 Tenn. 281; s. c. 24 S. W. Rep. 252.

funding act, and accept bonds guarantied by the State in exchange for their coupons, forfeit the priority to which they were entitled as holders of those coupons.[1]

And if, in such a case, the proceeds of the sale are insufficient to discharge the claims of all the secured creditors, the first-lien bondholders who retain their bonds may insist on receiving the full advantage of their priority. The diminution in the number of their class resulting from the fact that some of them have surrendered their bonds, and thus lost their rank as first-lien bondholders, will not inure to the benefit of junior classes of bondholders.[2]

§ 777. **Relative Rank of Preferred Stockholders and Bondholders.** — Whether preferred stockholders can assert a priority of lien as against subsequent bondholders depends upon what actually occurred at the time the agreement was entered into under which the preferred stock was issued, and upon what contracts affecting the property were entered into by the parties having the right to incumber the property, and not upon what may have been in the minds of the preferred stockholders themselves at the time the various transactions took place. An agreement which merely provides that the preferred stock is to be "a first claim on the property of the corporation after its indebtedness," and that the interest on such stock shall be paid before any dividends on common stock, will be construed as merely prescribing a method by which the holders of the preferred stock are to receive a preference as against the holders of common stock, and not as meaning that the "indebtedness" referred to should be that indebtedness only which then existed against the company. To attribute any other meaning to the contract would contravene the general rule that where stockholders claim a priority of payment over mortgage creditors, a specific lien must be shown beyond all doubt to exist in their favor.[3]

There is no statutory power in a corporation in Ohio, Indiana, or Illinois to issue certificates of preferred stock, and make it a lien upon the property or assets of the corporation.[4]

Preferred stockholders have sometimes been held to be such

[1] Hand *v.* Savannah & Charleston R. Co. (1880), 12 S. C. 314; approved in Hand *v.* Savannah & Charleston R. Co. (1882), 17 S. C. 219; s. c. 12 Am. & Eng. R. R. Cas. 495.

[2] Ibid.

[3] King *v.* Ohio & Mississippi R. Co. (1880), 2 Fed. Rep. 36; s. c. 9 Biss. 278 (1880), per Drummond, J.

[4] Continental Trust Co. of New York *v.* Toledo, St. Louis, & Kansas City R. R. Co. (1896), 72 Fed. Rep. 92.

only in name, their real position being that of persons who have lent money on mortgage security.[1] But in no case have the courts shown any disposition to depart from the general rule that "stockholders are not entitled to any share of the capital stock nor any dividend of the profits, until all the debts of the company have been paid."[2]

In Chaffee *v.* Rutland & Burlington R. Co.[3] it was strenuously contended that a charter providing for the issue of preferred stock by a company organized by the holders of second-mortgage bonds, during proceedings for foreclosure of their lien was intended to provide means of exchanging the first-mortgage bonds into preferred stock, without affecting the security, the result being to give the scrip certificates for the amount of the dividends, convertible into bonds at the option of the holder, a priority over the floating indebtedness. The whole subject was very elaborately discussed by Judge Veazey, and the conclusion arrived at that the preferred stockholders possessed every privilege of shareholders and were exempt from none of their liabilities; they must be treated as shareholders, as against persons to whom any part of the floating indebtedness was owing. This consequence was not prevented by the mere fact that, under the charter, the preferred stock was to be issued only for the purpose of paying or taking up prior claims or incumbrances, and that no mortgage should take precedence of the preferred stock in the application of the income. These provisions were merely safeguards, designed to secure the benefit of a preference between the two kinds of stock, and not of a preference over the creditors of the corporation.

§ 778. **Judgments against Corporation for Damages.** — Judgments against the corporation for injuries to person or property are, as we have seen, not usually reckoned among preferential debts, even as against the earnings of the receivership. *A fortiori* will they give the claim no priority, as against the mortgagees, in the distribution of the proceeds of the sale.[4]

[1] This was held to be the result of the issue of preferred stock in Burt *v.* Rattle (1876), 31 Ohio St. 116, where the issue was made subject to the provisions of a statute expressly declaring that the preferred stock should neither give its holders a right to vote nor affect them with liability for the debts of the corporation.

[2] Railroad Co. *v.* Howard (1868), 7 Wall. 392.

[3] 55 Vt. 110; s. c. 16 Am. & Eng. R. R. Cas. 408.

[4] In Receiver *v.* Stanton (1894), 86 Tex. 620, the court, after a brief reference to the rule stated in the text, discussed the effect of the Texas statute, prescribing the order in which several classes of debts, including certain "back claims," were to be paid, upon the appointment of a receiver, out of such earnings as came into his

But in some States a different rule is established by statute. Thus, under section 1255 of the South Carolina Code, which provides that "mortgages of incorporated companies, . . . whether in bonds or otherwise, shall not have power to exempt the property or earnings of such corporations from execution for the satisfaction of any judgment obtained . . . for torts committed by such corporation whereby any person is killed, or any person or property injured," it has been held that a judgment for personal injuries received before or after the execution of the mortgage takes precedence of such mortgage in the distribution of the proceeds.[1]

A statute of this description has no extra-territorial force.[2]

A statute which makes a judgment a lien on the real property of the debtor "from the first day of the term at which it is rendered," does not confer any priority on a claim for damages which has not been reduced to judgment until more than a year after the sale of the road. Under such circumstances there is no property of the company upon which the lien of the judgment can attach at the time of its rendition. After the sale "the relation of the property to the company is in all respects as if the company never owned it." And since there is "no such lien at law upon the road, there can be none in equity touching the fund arising from the sale."[3]

So also the foreclosure of a junior mortgage, and a decree of sale subject to the prior liens, effectually cuts off the lien of all judgments recovered against the maker of the mortgage so fore-

hands. As the statute made a judgment for a tort of the company a lien only on the *earnings*, the right of a creditor who had recovered such a judgment to resort to the *corpus* of the property for satisfaction was denied.

[1] Finance Co. of Pennsylvania *v.* Charleston, C. & C. R. Co. (1894), 61 Fed. Rep. 369. The reasoning of the court was that the statute recognized the equity enforced under the doctrine of the line of cases beginning with Fosdick *v.* Schall (1879), 99 U. S. 235, viz., that "whoever contributes to keep a corporation a going concern by materials or labor must be provided for before mortgage creditors can claim out of the earnings." The preferred expenses, it was considered, include "all damages done to life, person, or property in keeping up the road." The decision is, doubtless, correct; but it must rest upon the words of the statute alone, for the analogy here emphasized by the court is not in accordance with the weight of authority. See chapter on preferred debts.

[2] Central Trust Co. *v.* East Tennessee, Va. & Ga. Ry. Co. (1895), 69 Fed. Rep. 658.

[3] Jeffrey *v.* Moran (1879), 101 U. S. 285. It was also contended that the words of the statute, "the lien of judgments recovered against the corporation," were equivalent to "valid claims against the corporation;" but the court said: "No reasoning can successfully maintain that a claim merely in judgment and a judgment *lien* are the same thing in legal effect any more than in fact. To hold otherwise would be to make the law not to apply to it. It is only when a claim has ripened into a judgment, where there is property to be bound by it, that a lien can subsist."

closed, and if any of those are not recovered till after the sale has actually taken place, they can never become liens on the property at all.[1]

§ 779. **Priorities of Builder of Extension of Road during Receivership.** — It has been stated above that the court has no power, without the consent of the lien-creditors, to charge the *corpus* of the estate, and possibly not even the income, with the expense of constructing additions to the road or making permanent improvements partaking of the character of actual additions. An order authorizing construction work, entered with the consent of some of the bondholders, only binds those who do consent. If the receiver undertakes to act upon such an order, and contracts to build an extension at a cost not to exceed a specific sum, the payment of which is to be made "out of the surplus income," he is to be regarded as having acted merely as the agent of the consenting bondholders; and if the work is done at a greater cost than that agreed upon, and finally sold as a part of the entire road, with his acquiescence, he will merely have an equity to share the proceeds of the sale to the extent that the section built by him has enhanced the price brought by the whole property. On the other hand the proportionate share of a bondholder who refused to consent to the extension is entitled to his proportionate share of the entire proceeds of the sale.[2]

§ 780. **Receiver's Operating Expenses not Payable out of Proceeds.** — The operating expenses of a receiver are not payable out of the proceeds, unless by the authority of the court regularly given in proceedings of which the lien-creditors have had due notice. (See Chapter XXX., relating to receivers' certificates.) A different doctrine is, of course, applicable when the claimant relies on a specific lien, and not merely on the fact that his debt is for operating expenses. Thus it has been held that a mortgage lien will be postponed in the distribution of the proceeds to a claim for the rental of rolling-stock sold to the company, with a vendor's lien reserved, and used by the receiver in operating the road.[3]

[1] Bronson *v.* La Crosse & Milwaukee R. Co., 2 Wall. 283, 304.

[2] Hand *v.* Savannah & Charleston R. Co. (1881), 17 S. C. 219; s. c. 12 Am. & Eng. R. R. Cas. 495.

[3] Kneeland *v.* American Loan & Trust Co. (1890), 136 U. S. 89; s. c. 43 Am. & Eng. R. R. Cas. 519.

In a Canadian case, Gray *v.* Manitoba & Northwestern Ry. Co., 32 Can. L. J. N. S. 167, the working expenses of the whole railway were declared in an amended decree of sale to be a first lien on the revenue, and must be provided for in priority of the claim of the mortgagees. See this case affirmed and modified in House

Among the operating expenses which are payable out of the income of the receivership only are the amounts awarded as damages for injuries resulting from the acts of the receiver's servants.[1]

A fortiori if the receiver was appointed merely for the purpose of realizing profits to pay arrears of rent, and is rather a managing agent for the various parties in interest than a technical receiver, there is no warrant for selling the property to discharge a floating debt which the earnings of the road are insufficient to liquidate.[2]

§ 781. **Amount recoverable by Pledgees of Bonds.** — (Compare Chapter II.) A pledgee of bonds, if a *bona fide* holder for value before maturity, may prove for the entire amount due thereon, but cannot recover more than the amount of his advances, with proper costs of suit.[3]

Thus, where the company authorizes an agent to raise money for its uses, and delivers bonds to him to be deposited as collateral security for such money as he might borrow, a lender who makes advances on the personal note of the agent and the security of a portion of the bonds intrusted to him will not be entitled to receive the full amount of the bonds and account to the agent, but only the amount of his loan and interest. It is error in a master or referee to leave the excess in the hands of the creditors, for when the proceeds of a sale of the mortgaged property are brought into court, it is its duty to make distribution of the entire fund according to law and equity.[4]

§ 782. **Pledgee not entitled to share in Proceeds when Pledge is ultra vires.** — Where an issue of coupon bonds secured by mortgage on the real estate of a corporation is authorized by the board of directors "for the purpose of raising money to pay off the floating debts of the company," the powers of the agent deputed to negotiate the bonds are restricted according to the

of Lords (1897), L. R. App. Cas., p. 254.

The court may, in an action of a debenture-holder, decline to order a sale of the property of a company which is of public utility in its purposes. Blaker *v.* Hertz & Essex Waterworks Co., 41 Ch. Div. 399.

[1] Hand *v.* Savannah & Charleston R. Co. (1882), 17 S. C. 219; s. c. 12 Am. & Eng. R. R. Cas. 495; Ryan *v.* Hays (1884), 62 Tex. 42; s. c. 23 Am. & Eng. R. R. Cas. 501.

[2] Vermont & Canada R. Co. *v.* Vermont Central R. Co. (1877), 50 Vt. 500; s. c. 14 Am. Ry. Rep. 497.

[3] Morton *v.* New Orleans & Selma Ry. Co. (1885), 79 Ala. 590, 621, citing numerous cases, among others Duncomb *v.* New York, Housatonic, & Northern R. Co., 84 N. Y. 190, where a ruling of the referee, based on this doctrine, was approved by the court without any question as to its correctness.

[4] Rice's Appeal (1875), 79 Pa. St. 168.

terms of the mortgage. A pledge of the bonds to secure a prior debt of the mortgagor is, therefore, *ultra vires*, and the pledgee has no legal right to share in the proceeds of the mortgaged property.[1]

§ 783. **Lienholder on Part of Road, when entitled to be paid out of Whole Proceeds.** — One who has a lien on a part of a road only is entitled to be paid out of the aggregate proceeds of the property, when the receiver, in consideration of the surrender of the lien, agrees to pay a specified sum in satisfaction of such a lien out of any money coming into his hands from the part of the road covered by the lien, or "arising from the sale thereof under the decree of the court," and subsequently procures a sale of the property as an entirety. The right of the lienor to be thus paid is not to be defeated by the fact that the bondholders exercise the privilege given by the decree to make payment not in cash, but in bonds. If the purchasers fail to discharge the lien in a reasonable time fixed for that purpose, the property should be sold again as an entirety, or so much thereof sold as may be necessary to raise that amount due to him, with interest and costs from the time he intervened to assert his rights.[2]

§ 784. **Surplus, after paying Bondholders, belongs to Unsecured Creditors of Company.** — Whenever the lien of the bondholders is legally discharged, the property embraced in the mortgage, or whatever remains of it, belongs to the corporation, and is a part of the assets for the payment of its other debts. Any compromise arrangement between the bondholders and stockholders which ignores the paramount right of the general creditors to any surplus remaining after the claims of the various lienors have been satisfied, is fraudulent as against such general creditors. For the purposes of this rule it is immaterial that the property is mortgaged for a sum exceeding the price which it would fetch at an ordinary foreclosure sale, and that, if such a sale had actually taken place, there would have been no funds available for distribution among the general creditors. Any sum which is set free for the stockholders in consequence of the consent of the lienors to surrender a part of their rights belongs to the general creditors.[3]

The same principles are applied where the bondholders, for their own interest, become parties to an arrangement by which

[1] Shaw *v.* Saranac Horse Nail Co. (1894), 144 N. Y. 220; s. c. 39 N. E. Rep. 73.

[2] Farmers' Loan & Trust Co. *v.* Newman (1887), 127 U. S. 649.

[3] Railroad Co. *v.* Howard (1868), 7 Wall. 392.

the sale of the trust property is arrested, and the unsecured creditors are deprived of their right to satisfaction out of any surplus which may result from such sale. Thus, if the bondholders, instead of proceeding to a sale after the rendition of a decree of foreclosure, enter into an agreement with the company, by which the property is to be leased to another company for a rental, expressed in terms of a percentage of the earnings and whatever surplus remains, after applying that rental to interest, taxes, etc., is to be handed over to the lessor company, the holders of unsecured notes given in liquidation of a debt growing out of the construction of a part of the insolvent's road, and to prevent a lien thereon, are entitled to have their debts established as equitable liens upon the property and funds of the insolvent road paramount to the lien of the mortgage.[1]

[1] Farmers' Loan & Trust Co. *v.* Missouri, I. & N. R. Co. (1884), 21 Fed. Rep. 264; s. c. 17 Am. & Eng. R. R. Cas. 314.

CHAPTER XXXV.

SALES OF MORTGAGED PROPERTY.

§ 785. **Manner of Sale generally.**[1] — A chancery court has the power, and it is its right and duty, to supervise all sales made under its decrees and made by its special officers or commissioners, and to protect the parties from all fraud, mistake, unfairness, and imposition. This right of the court extends also to purchasers at such sales, who, by the act of purchase under the decree, submit themselves to the jurisdiction of the court.[2]

The statutes of a State requiring the sale of property by sheriff under process of execution or order of sale may be resorted to by the court administering the property through a receiver; but such statutes are not exclusive in effecting sales of this character, and the court may, in the exercise of its discretion, order a sale by the receiver or commissioners.[3]

When the property cannot be sold for cash for an amount sufficient to pay the bondholders, possibly the most equitable modes of disposing of it are to decree a strict foreclosure in which all will participate alike, or to make a sale for the equal benefit of all the bondholders who choose to come in and partici-

[1] See Woods' Ry. Law, 1636; Rorer on Railroads, 911, 913.

The validity of a foreclosure sale, in so far as it depends upon the jurisdiction of the court to order it, or the *lex loci rei sitæ*, is discussed in Chapter XXI.

[2] Parker *v.* Bluffton Car Wheel Co. *et al.* (Ala., 1896), 18 So. Rep. 938, in which the court approved the confirmation of a receiver's sale over the objection that the price was inadequate, etc.

[3] Farmers' & Merchants' Nat. Bank *v.* Waco Electric Ry. & Light Co. (Tex. Civ. App., 1896), 36 S. W. Rep. 131.

pate. But both of these methods have their drawbacks. A strict foreclosure involves special difficulties in those States where a mortgage is a mere security, and does not give a legal title, and, besides this, it places the property in the hands of a vast number of beneficiaries whose consent may be very hard to obtain in perfecting a new organization for conducting the business. A sale for the benefit of all is attended with the difficulty of determining who shall make the bid. The court sometimes authorizes the trustees to bid for the bondholders; but it is obvious that, in such a case, one class or other of the bondholders would be dissatisfied with any selection of trustees which the court might make; while, on the other hand, to decree that all the bondholders shall be allowed to participate in any sale that may be made would practically nullify an auction sale, inasmuch as no one could be expected to bid on such terms.[1]

In view of these difficulties, the court will sometimes avail itself of a plan of reorganization which aims at obviating the necessity of any sale, and postpone the sale for the purpose of giving the bondholders who have not assented to the plan an opportunity of coming in, ordering, at the same time, that if the property shall, after all, be sold and purchased in behalf of the reorganizing combination, the non-assenting bondholders are to be allowed to participate in such purchase on the same footing as the others.[2]

§ 786. **Sale of Property as Entirety.** — Whether the property is to be sold as an entirety is an inquiry which presents itself in two forms. The fact that a railroad is a property of an extremely composite character naturally presents the question whether a court would be justified in selling the component elements of that property separately. On the other hand, the fact that a railroad is often a property of vast extent, running, it may be, through several States, and that its several subdivisions are not infrequently subject to separate liens, the foreclosure of one of which only may be sought in the pending litigation,. gives rise to some grave and difficult problems in regard to expediency or inexpediency of breaking up the system under the given circumstances.[3]

1 Duncan *v.* Mobile & Ohio R. Co. (1879), 3 Woods, 597.

2 Ibid.

3 See generally, as to sale of railroad as an entirety, Woods' Ry. Law, 1640, 1642, and the note to 1 Am. & Eng. R. R. Cas. 516. See also Stephen *v.* Banque d'Hochelaga, M. L. R. (1886), 2 Q. B. (Can.) 491. On the *sale of a section of a road* where part is within and part without the jurisdiction of the court, see Gray *v.* Manitoba & Northwestern Ry. Co. (1897), L. R. App. Cas. 254. Compare Compton *v.* Jesup (1897), 167 U. S. 1.

The former question does not seem to have been much discussed, the courts assuming, perhaps, that in the case of such a property, everything of which it consists, both realty and personalty, must be sold together. Certainly where the mortgage itself provides that the personal property embraced in it shall be sold with the other property, the mortgagor cannot complain that the sale is so made.[1]

And the true rule possibly is that when a railroad, its appurtenances, and franchises are mortgaged as a whole, there is no power or authority to sell them separately.[2]

But in Ohio it has been held that the real estate of a railroad must be sold subject to rules governing real estate, and must, therefore, be appraised. As to this appraisement, it was said the court had no discretion; but, on account of the peculiar nature of the property, it might apply to the details of the proceedings, a more stringent or more liberal rule than the one ordinarily adopted, as might be demanded by the circumstances of the case.[3]

As to the proper way of disposing of the property where, as in the common case of foreclosure for interest, the total value of the entire system, or even of the division covered by the mortgage which it is sought to enforce, is greater than the sum demanded, the authorities are not entirely harmonious. In some of the earlier cases relating to foreclosure sales we find the rule laid down that, where the interest only is in default, so much of the property should be sold as will discharge the

[1] Wood *v.* Whelen (1879), 93 Ill. 153.

[2] Peoria & Springfield R. Co. *v.* Thompson (1882), 103 Ill. 187; s. c. 7 Am. & Eng. R. R. Cas. 101. In this case the court, adopting this conclusion, drew the further inference that, as a railroad was, strictly speaking, neither realty nor personalty, it did not fall clearly within the Illinois statute providing that real estate must be sold subject to redemption, and that, as there was as much reason for considering it to be personalty as realty, railroad real estate was presumably to be excepted from the general provision. This opinion was based partly on considerations of public policy, which, it was thought, warranted the court in giving this construction to the statute. The ruling is in conflict with Turner *v.* Indianapolis, B. & W. Ry. Co. (1878), 8 Biss. 380, which holds that a railroad must be sold subject to redemption, as provided by the statute.

[3] Coe *v.* Columbus, Piqua, & Indianapolis R. Co. (1859), 10 Ohio St. 372. In this case the court ordered "(1) That the railroad, with its fixtures, constituting an entire tract of real estate, indivisible for the purpose of the sale, together with the franchise connected therewith, should be sold in like manner as an entire tract lying in two or more counties, the proceedings incidental to the sale to be had in the county in which the action was brought; (2) That the personal property should be sold as personal property, but with such precautions as to prevent a sacrifice, and to procure the highest price, as the court in its discretion might order."

amount due,[1] — this rule, of course, being understood with the implied limitation that the property involved is susceptible of division; otherwise that the sale of the property should be as an entirety, or that it should be leased, if the company preferred it, for the shortest term that would bring the amount due.[2]

The rule thus acted upon, if expressed formally, would be, that, when a railroad cannot be divided and sold in pieces without manifest injury to its value, the whole may be sold even before the principal is due, upon default in the payment of interest upon a mortgage which covers only a specific portion of the property, while if such a division is feasible, without detrimentally affecting the interests of all the parties in interest, the section incumbered should alone be sold, so that every incumbrancer may have the chance of protecting his securities without involving himself in onerous engagements.[3]

On the authority of the more recent decisions, however, it seems justifiable to state the rule much more strongly in regard to the propriety of selling a railroad as an entirety. It may be said that the courts now proceed upon the assumption that a railroad is so rarely susceptible of being broken up without detriment to the parties in interest, that a sale of the property in parcels should never be ordered, unless the special circumstances of the case indicate the expediency of such a course. Thus it has been expressly declared that, since a railroad and its appurtenances are in the nature of an entirety, the elements of which are so essentially intermingled that they cannot be sold separately without disastrous results to all concerned, a claim for unpaid interest on bonds should be satisfied by authorizing a sale of the whole premises, although the principal is not due.[4]

[1] Goodman *v.* Cincinnati & Chicago R. Co. (1858), 2 Disney (Ohio), 176. In this case the discussion turned upon whether the property could be sold at all to pay mere arrears of interest. There were no arguments presented as to the impolicy of dividing the railroad by selling separate portions of it.

[2] Bardstown & Louisville R. Co. *v.* Metcalfe (1862), 4 Metc. (Ky.) 199. In Allen *v.* Montgomery & West Point R. Co. (1847), 11 Ala. 437, the court, without passing directly on the point, said it was very questionable if the sale would be opened at the instance of a judgment creditor on the ground that it was in gross, unless it was shown that there had been fraud, or that the property would have commanded a larger sum if sold in lots.

[3] Wilmer *v.* Atlanta & Richmond Air Line R. Co. (1872), 2 Woods, 447; Farmers' Loan & Trust Co. *v.* Oregon & C. Ry. Co. (1885), 24 Fed. Rep. 407. Compare Campbell *v.* Texas & New Orleans R. Co. (1872), 2 Woods, 263.

[4] McFadden *v.* May's Landing & Egg Harbor City R. Co. (1891), 49 N. J. Eq. 176; s. c. 22 Atl. Rep. 932.

In other words, the legal and proper mode of selling railroad properties is in gross, not in parcels.[1]

Such is also the rule as to a sale under a power, which, it is held, must be executed upon all the property mortgaged.[2]

A railroad company gave a mortgage in Arkansas upon "all of the property, real and personal," belonging to it, with a subsequent specific description of the kinds of property to one, to secure a note of the company given him for an indebtedness, probably for construction. In his foreclosure suit there was a decree ordering the property conveyed by the deed of trust sold to satisfy the judgment. The company requested the court to order specifically that the property be sold as a whole. This the court declined to do, and the company excepted. On appeal, the Supreme Court, after referring to the provision of the Constitution of Arkansas, art. 17, § 11, declaring that "rolling-stock" of railroad companies should be "considered personal property," said, "Notwithstanding this provision of the constitution requires us to treat this rolling-stock as personal property, it was still within the discretion of the Circuit Court to have ordered the property covered by this deed of trust to be sold in bulk, as an entirety, for the deed, by its terms, does not seem to contemplate but one sale." It was then intimated that the wishes of the debtor might have been followed, if it was clear that it could be done with safety to the creditor and without injury to others having claims against the company or its property. They construed the order of sale to be on the line of this principle, one which would allow the commissioner to offer it as a whole; and if no bids could be obtained in that way, then to offer the real and personal property separately, and leave the final determination of the question when there was an application for confirmation of the sale.[3]

Where a company has mortgaged its entire road, and abandoned its construction after completing the middle section, and the work is afterwards finished by another company, it is error

[1] Sahlgaard *v.* Kennedy (1882), 13 Fed. Rep. 242, 245. Compare Chicago, D. & V. R. Co. *v.* Fosdick (1882), 106 U. S. 47; Credit Co. *v.* Arkansas Central R. Co. (1882), 15 Fed. Rep. 46; Farmers' Loan & Trust Co. *v.* Oregon & C. Ry. Co. (1885), 24 Fed. Rep. 407, supporting the same doctrine in more or less decided terms.

On the question whether the sale of a tramway can be had if the purposes of the way would be defeated, see Marshall *v.* Tramways Co. (1893), L. R. 2 Ch. 38. This general question is discussed earlier in this treatise. See also Bartlett *v.* Tramways (1894), L. R. 2 Ch. 287.

[2] Coe *v.* Columbus, Piqua, & Indianapolis R. Co. (1863), 14 Ohio St. 187.

[3] Southwestern Arkansas & I. T. Ry. Co. *v.* Haya (Ark., 1897), 38 S. W. Rep. 665.

to order a sale of the middle section only, leaving the remainder valueless. The entire road should be sold, and the proceeds distributed between the new company and the mortgagee according to the ratio which the work done by the first company bears to the value of the whole road, as completed.[1]

The rule that a railroad may be sold as an entirety, wherever it cannot be sold in parcels without loss and prejudice to the parties in interest, is applicable to a system created by the consolidation of several distinct divisions, upon which separate mortgages have been given prior to the consolidation.[2]

The fact that the particular division on which a mortgage rests is sold at the same time as other divisions of the road, does not violate in any manner the contract entered into with the mortgagee, for a sale of all the separate divisions is plainly an effectual performance of the stipulation providing that each separate division may be sold upon default. The fund, after the sale, will be apportioned upon equitable principles according to the earnings of the different divisions of the road, with the result that the lienholders of the different divisions will receive in the distribution the proportion to which they are entitled; and if the expectation which is the inducement for adopting this method of sale is that the total sum to be apportioned will be larger than the aggregate of the prices which the divisions would have sold for, if sold separately, the arrangement will, evidently, be beneficial to all the mortgagees.[3]

Quite in a line with the principle of the decisions cited above is the rule laid down by a federal court, that a sale under execution cannot be made separately of that part of the road not subject to the lien of the mortgage, but that the entire road, for the purposes of sale, must be treated as indivisible, the proceeds being brought into court, and distributed with due regard to the priority of the liens and the portions of the road respectively subject to those liens.[4]

So also, where a number of *fi. fas.* are proceeding against a railroad in the various counties through which it passes, it has been held that to allow the road to be thus cut up into fragments would not only sacrifice the rights and interests of cred-

[1] Chicago, Danville, & Vincennes R. Co. *v.* Loewenthal (1879), 93 Ill. 433.

[2] Grinnell *v.* Trustees (Ohio Ct. of Comm. Pl., 1857), 2 Redf. Law of Railways, 498.

[3] Gibert *v.* Washington City, Va. Midl. & Great Southern R. Co. (1880), 33 Gratt. (Va.) 586; s. c. 1 Am. & Eng. R. R. Cas. 473.

[4] Ludlow *v.* Clinton Line R. Co. (1861), 1 Flip. 25.

itors, but defeat the objects and intentions of the legislature in granting the charter, and that a court of equity may therefore properly interfere, and, having enjoined the executions, direct a sale of the entire property for all concerned.[1]

§ 787. **Power of Court and Officers to postpone Sale.** — A court of equity, after a decree in foreclosure ordering the sale of a railroad, will, if necessary, take the responsibility of delaying the sale to await a better condition of the finances and business of the country that exists at the time of the decree. But the fact that a railroad begins, after a period of financial adversity, to show a prosperous state of earnings, indicating that in a few years it will be able to pay off an accumulation of overdue and unpaid interest, does not furnish ground for a postponement of its sale in foreclosure, — especially if the company owning the railroad offers no guaranty that such prosperity will continue.[2]

A sale may also be postponed where, owing to the operation of a statute, only a portion of the property can be sold immediately, and it seems advisable in the interests of all parties that the property shall not be dismembered.[3]

The court will not postpone the sale where an appeal is taken more than sixty days after the foreclosure decree, and therefore fails to operate as a *supersedeas*. The taking of such an appeal does not cast such a shadow on the title as to afford a ground for postponement.[4]

In regard to a sale which is actually in progress, the officer designated to conduct it has a limited discretion as to whether it shall be adjourned to prevent a serious sacrifice of the property, as, for instance, where only a single bidder attends the sale. A master or a marshal, in carrying out an order of sale, is something more than an auctioneer. They have duties to perform, and while engaged in the performance of those

[1] Macon & Western R. Co. *v.* Parker (1851), 9 Ga. 377.

[2] Duncan *v.* Atlantic, Mississippi, & Ohio R. Co. (1880), 4 Hughes, 125.

[3] Benedict *v.* St. Joseph & W. R. Co. (1883), 19 Fed. Rep. 173, 175. A Kansas statute (Comp. L. § 3983) provided that no order of sale, on the foreclosure of a mortgage, containing a waiver of the appraisement of the real estate could be issued until the expiration of six months. It was held that, in view of such a statute, the sale of the entire property should be postponed. "The complainants in the present case," said the court, "have no absolute right to an immediate sale, even of the personal property and corporate franchises. It is not therefore necessary, in order to follow the statutes, that we divide and dismember the mortgaged property. The stay can be ordered as to the entire property, and its unity thereby be preserved, and the statute at the same time enforced, and all rights under it maintained."

[4] Duncan *v.* Atlantic, Mississippi, & Ohio R. Co. (1880), 4 Hughes, 125.

duties may postpone the sale for good cause shown. All that can be required of them is that they make themselves acquainted with the circumstances, and act in good faith.[1]

§ 788. **Conduct of Sale under Power in Mortgage generally.**[2] — When an express power to sell is conferred on the trustee, it must be strictly followed in all essential respects.[3]

An authority to sell "as provided by law" has been held to mean according to the law regulating public sales made pursuant to decrees.[4]

A sale made in pursuance of a power is virtually a foreclosure of the mortgagor's equity of redemption; for the mortgagor has created the power expressly to give the purchaser a perfect title to the whole estate, and thus to secure to himself the benefit of an outside price.[5]

§ 789. **Sale under Power not postponed till Number of Bonds justly due ascertained.** — Where the deed of trust makes it the duty of the trustee to exercise the power of sale given by the instrument upon receiving the written request of a majority in interest of the bondholders, the sale will not be delayed merely to ascertain how many of the bonds are justly due. Each bondholder holds his own bonds separately and independently of the others, and when his interest remains in arrear under the circumstances mentioned, he ought not to be delayed by a controversy which has arisen about the validity of bonds held by other persons. In this respect the proceedings differ from those in the case of an ordinary foreclosure sale, for upon the filing of a bill to foreclose a mortgage the authority conferred upon the court is to decree a sale unless the debt and costs are paid at or before the time fixed by the decree; and it is necessary for the court to ascertain the amount of the debt, so that the defendant

[1] Blossom *v.* Railroad Co. (1865), 3 Wall. 196. In this case the decree was to the effect that the property should be sold at a certain time, unless the mortgagor should previously pay the mortgage debt; and it was held that a few short adjournments, to enable the mortgagor to make arrangements to pay the amount due on the mortgage, were allowed for a sufficient cause, although granted at the instance of the plaintiff's solicitor. As to the power of a trustee to postpone a sale made under a power in the mortgage, see Jones on Mortgages, § 1873.

Debenture-holders cannot be restrained from selling property of the company on which their debentures are a charge by a liquidator of the company in a winding up on the ground that a sale by him would realize more money. Perry *v.* Oriental Hotels Co., 12 Eq. 127; Longendale Spinning Co., 8 Ch. Div. 150.

[2] As to the cumulative character of this remedy, see *ante*, on remedies.

[3] Bradley *v.* Chester Valley R. Co. (1860), 36 Pa. St. 151.

[4] Brunswick & Albany R. Co. *v.* Hughes (1874), 52 Ga. 557; s. c. 7 Am. Ry. Rep. 137.

[5] Bradley *v.* Chester Valley R. Co. (1860), 36 Pa. St. 151.

may know how much it is necessary for him to pay in order to prevent the sale.[1]

§ 790. **Place of Sale.** — It has been held in Maryland that the statute of that State prohibiting a sale of mortgaged premises out of the county in which they lie refers to technical mortgages only, and has no application to a trust deed giving the trustees a power to enter upon and sell a railroad when the interest on the bonds secured by the instrument is in default.[2]

§ 791. **Advertisement of Sale under Power.** — It is proper, if not necessary, that the advertisement should state how the sale will be made. It should be made known generally, as well as to the purchasers, whether a sale will be subject to the debts and liabilities of the old company or not.[3]

Where a power of sale is to be exercised by a trustee, in case of continued default for sixty days after notice to the mortgagor of an intention to sell, but not until the sale has been previously advertised for sixty days, the two periods are not synchronous, but successive. The term required for the advertisement to run does not begin until the term of the prescribed notice has expired.[4]

If the decree required notice of the sale of the property to be advertised in certain newspapers, among which was A., printed in a certain city, and it appears that before such advertisement was inserted A. had been merged into B., or its name changed to B., the identity of the paper remaining, the advertisement in B. is a substantial compliance with the order.[5]

A notice of foreclosure by advertisement, stating that the sale will be held at the court in a designated village and county, sufficiently describes the place of sale.[6]

Where a trust deed gives the trustee the power to advertise and sell the mortgaged premises on default of payment, when so requested by the holder of the indebtedness, giving thirty days' notice of such sale, these provisions must be strictly complied with to render the sale valid.[7]

§ 792. **Reserved or Upset Prices.** — The practice of the English Court of Chancery, established first by rules of court, and then

[1] Brown *v.* State of Maryland (1885), 64 Md. 199; s. c. 24 Am. & Eng. R. R. Cas. 192.

[2] Harrison *v.* Annapolis & Elk Ridge R. Co. (1878), 50 Md. 490.

[3] Alexandria, Washington, & Georgetown R. Co. *v.* Alexandria & Washington R. Co. (1870), 19 Gratt. (Va.) 592, 618.

[4] Macon & Augusta R. Co. *v.* Georgia Railroad Co. (1879), 63 Ga. 103; s. c. 1 Am. & Eng. R. R. Cas. 378.

[5] Sage *v.* Central R. Co. (1879), 99 U. S. 334.

[6] McCammon *v.* Detroit, L. & N. R. Co. (1894), 103 Mich. 104; s. c. 61 N. W. Rep. 273.

[7] Equitable Trust Co. *v.* Fisher (1883), 106 Ill. 189.

by legislation, is a system of reservation bids, under which the court, upon application of the parties or of its own motion, ascertains the probable value of the property as nearly as may be, and determines the lowest price it is willing to take, has received the approval of the federal courts. The property is not sold unless at public auction it brings as much or more than this reserved price, which, as it is not "revealed" until after the sale, cannot influence the biddings.[1]

By fixing an upset price the court intends to convey the meaning that it is better that the road shall sell at that price than not at all. If the road sells above the upset price, the sale will not be set aside on the ground of the inadequacy of the price, because, in the light of subsequent events, the property proves to have been of greater value.[2]

The Circuit Court, in the case of Southwestern Arkansas & I. T. Ry. Co. *v.* Hays, in its decree of sale of the railroad property in a foreclosure suit on the mortgage deed securing the debt, required the commissioner of sale to have the property appraised, and not to sell it for less than two-thirds of its value. This was excepted to by the mortgagee, and, on appeal, the exception was sustained and the decree modified in this respect. The Supreme Court said: "As the mortgage in this case confers the right to an absolute sale, it is doubtful whether the court could prevent such a sale by requiring that the property should be appraised and not sold for less than two-thirds of its value." They assumed that the court was prompted to this order by a belief that the statute of Arkansas, regulating sales under powers of sale contained in mortgages of deeds of trust, applied in such a case, but reiterated the rule that it did not apply to sales under decrees of court.[3]

§ 793. **Bids.** — The question of sale or no sale, so far as it depends on the validity of the bid, is tested by the same rules

[1] Blackburn *v.* Selma R. Co. (1880), 3 Fed. Rep. 689, 692. For upset price named in decree, see Blair *v.* St. Louis, H. & K. R. Co. (1885), 25 Fed. Rep. 232, 240, and Wetmore *v.* St. Paul & Pac. R. Co., 3 Fed. Rep. 177, 183.

[2] Wetmore *v.* St. Paul & Pac. R. Co. (1880), 3 Fed. Rep. 177, 183, per Miller, J.

As to power of court to change the reserved or upset price in its decree, see Farmers' Loan & Trust Co. *et al.* *v.* Oregon Pac. Ry. Co. *et al.* (Oregon, 1895), 40 Pac. Rep. 1089.

[3] As to setting aside a sale for inadequacy of price, see Farmers' Loan & Trust Co. *et al.* *v.* Oregon Pac. R. Co. *et al.* (Oregon, 1895), 40 Pac. Rep. 1089.

Where the reserve bid is not made at a sale, and the amount bid is insufficient to pay off first and second mortgage debentures, a sale will be stayed and a foreclosure of the mortgages directed. Welch *v.* National Cycle Co. (1886), W. N. 27, 196.

substantially as those which are applicable in cases of sales under common-law process, or other sales at public auction. There is no sale where the property has never been struck off to the bidder, nor his bid, by act or word, or in any manner, accepted by the seller.[1] As to the power of the trustee to bid beyond the amount fixed, see *ante*.

§ 794. **Deposits by Bidders.** — To guard against the failure of a sale, and the consequent expense and delay, it is within the discretion of the court to require a deposit of money, or other satisfactory security that the terms of the sale will be complied with.[2]

A lien for the purchase-money may also be reserved on the property as an additional security.[3]

The amount of the deposit may reasonably be fixed in reference to the amount of cash required for the discharge of costs and other claims calling for immediate payment. But the officer conducting the sale should not be authorized to exact a cash advance before the close of the biddings. It is considered that any convenience that may result from possessing this means of eliminating spurious bids, during the progress of the bids is counterbalanced by the tendency of such a condition to chill the bids by deterring some parties from bidding.[4]

A court is justified in requiring each bidder at a sale of large railroad interests to make as large a deposit as $50,000.[5]

§ 795. **Liability of Bidders for Loss upon Resale.** — A reorganization committee which fails to make good its bids, not for want of funds, but because it thinks that the price was too high

[1] Blossom *v.* Railroad Co. (1865), 3 Wall. 196.

[2] Coe *v.* Columbus, Piqua, & Indianapolis R. Co. (1889), 10 Ohio St. 372, 409; Bardstown & Louisville R. Co. *v.* Metcalfe (1862), 4 Metc. (Ky.) 199.

[3] Bardstown & Louisville R. Co. *v.* Metcalfe (1862), 4 Metc. (Ky.) 199. This case also rules that, if the property is leased for the purpose of paying the arrears of interest, the lessee should be required to give bonds, with good security, for the payment of such arrears, and of the interest to accrue while he remains in possession, and, as an additional security, a lien on the term should be reserved. In such a case, the lessee should also be compelled to give a covenant, with good security, to keep in repair the roads, cars, and other property not consumed by use, and to return the same to the company at the end of the term in as good condition as it may be in when received; and, to prevent future controversy with reference thereto, the court, before ordering the lease, should cause an inventory to be made of the property, its value, condition, etc., which should be filed in the cause, and declared in the decree ordering the lease to be conclusive evidence of such value, condition, etc., at the commencement of the term.

[4] Hand *v.* Savannah & Charleston R. Co. (1880), 13 S. C. 467; s. c. 12 Am. & Eng. R. R. Cas. 488.

[5] Turner *v.* Indianapolis, B. & W. Ry. Co. (1878), 8 Biss. 380.

and that it might have made a better bargain, will not be excused, upon a resale of the property at a less price, from making good the difference, if the unsecured creditors will derive advantage therefrom.[1]

§ 796. **Payment in Bonds.** — If bondholders purchase the entire property, they have an equitable right, after satisfying the costs and charges of the litigation and the trust, to pay the balance in bonds, so far as their own proportion of the balance extends, for it is to come to them.[2]

The Supreme Court of the United States, in approving a decree which ordered the master to receive in payment bonds and coupons ascertained by him to be due and owing, and recognized by the court as valid obligations, remarked, with regard to the arrangement: "Permission to bondholders who are mortgagees to purchase at a sale of the mortgaged property and to pay by their bonds is not only usual, but it is highly advantageous to all persons who have an interest. It tends to enhance the price which may be obtained, and thus benefits other creditors as well as the mortgagor.[3]

Bonds should not be received in payment for a bid at a foreclosure sale of corporate property at par unless the purchase price is adequate to pay the par value of all outstanding bonds. If the price is inadequate to pay the par value, then bonds should be received from the purchaser only for the proportion of the sum bid as the holder of the bonds will be entitled to in the distribution of the proceeds.[4]

Where the court has required the payment in cash of a sum sufficient to discharge all allowed claims of general creditors

[1] Central Trust Co. *v.* Cincinnati, J. & M. Ry. Co. (1892), 58 Fed. Rep. 500.

[2] Duncan *v.* Mobile & Ohio R. Co. (1879), 3 Woods, 597, per Bradley, J. It was, however, pointed out by the learned justice that the result of the operation of this rule would evidently be to give those who, whether singly or in combination, hold a large portion of the bonds a great advantage over the minority, for they can pay their own proportion of the purchase-money, which is much the largest, in bonds, and have only a small amount in cash to pay; whilst the minority can only pay a small proportion in bonds, and have a large amount to pay in cash, which, as a general rule, they are quite unable to pay. This practically puts it in the power of the majority to get the property at a great sacrifice, and turn the minority off with a mere pittance.

[3] Ketchum *v.* Duncan (1877), 96 U. S. 659. This case was followed in Kropholler *v.* St. Paul & Pac. Ry. Co. (1880), 2 Fed. Rep. 302, where the purchaser was authorized to pay all his bid, except $50,000, in the debentures issued by order of the court and in the bonds secured by the mortgage foreclosed, at such a percentage of their fair value as should be equal to the dividend to which they would be entitled upon a distribution of the proceeds of the sale.

[4] Thayer, Circuit Judge, in American Waterworks Co. of Illinois *et al.* *v.* Farmers' Loan & Trust Co. (1896), 73 Fed. Rep. 956, 964.

and the expenses of the suit, the rest of the price being paid in bonds, the owners of such allowed claims, if they assent to the subsequent application of a part of this money to liabilities not properly chargeable against it, will be regarded as having waived their rights to the extent that such application affects the ability of the fund to discharge the principal and interest of their debts, and they cannot afterwards require the purchasers to substitute sufficient cash in lieu of bonds to pay their claims in full.[1]

Where the court decrees that, at the sale, the mortgage bonds may be received in part payment of the purchase price, it is not necessary nor customary to fix the value of such bonds prior to the confirmation of the sale.[2]

§ 797. **Who may be Purchaser.** — It is desirable to guard against the perils of a forced sale of a valuable property for cash. At judicial sales of railroads for cash there is, as is well known, little likelihood of obtaining a bid for a sum at all commensurate with the value of the property sold, or with the amount of incumbrances upon it, the amount required being usually so large, that it is beyond the reach of ordinary purchasers. The bondholders are generally the only parties that can become purchasers, because they need not pay their bid in cash. These are the reasons that so often an association of the bondholders is formed to effect a purchase. For convenience sake they usually appoint a purchasing committee to buy the property, take the title for the benefit of all, and transfer it to a new corporation.[3]

The arrangement in this case was made under the power given in the mortgage to a majority of the bondholders. The plan was for the trustee to purchase for their benefit, the minority being guarded in their interest. The court made a decree, therefore, authorizing the trustee to bid at the sale at least the amount of principal and interest of the first-mortgage bonds. This decree was approved by the Supreme Court on appeal. The validity of such associations of bondholders is fully recognized,[4] provided they are formed in good faith, and not with a view to prevent others from purchasing.[5]

[1] Central Trust Co. *v.* Cincinnati, J. & M. R. Co. (1892), 58 Fed. Rep. 501.

[2] Farmers' Loan & Trust Co. *v.* Green Bay & Minnesota R. Co. (1881), 10 Biss. 203.

[3] Sage *v.* Central R. Co. (1879), 99 U. S. 334, 339.

[4] Pennsylvania Transportation Co.'s Appeal (1882), 101 Pa. St. 576; Vatable *v.* New York, L. E. & W. R. Co. (1884), 96 N. Y. 49; s. c. 17 Am. & Eng. R. R. Cas. 268.

[5] Ketchum *v.* Duncan (1877), 96 U. S. 659, 674.

Stockholders may also combine under a like limitation to buy in the property, and save it from being sacrificed.[1] Where the property is thus bid in by a committee acting as agents for the bondholders, the fact that the return of the officer appointed to make the sale does not state who are the principals is no ground for refusing to confirm the sale. The court may take judicial notice that such a committee represents the owners of the property, and all that can be required of them is that it shall comply with the orders of the court.[2]

A purchase by the solicitor of the company, who takes the title for the bondholders, is not necessarily in and for itself invalid. He simply holds the title until the real purchasers are in a condition to take it themselves. Such purchases will be scrutinized closely, but, until impeached, they must stand.[3]

§ 798. **Confirmation of Sale.** — The sale is not final until a report is made to the court by the officer appointed to conduct it, and it is approved and confirmed. This report is subject to objection from either party, and the purchaser himself who becomes a party to the sale may appear before the court, and, if any mistake has occurred, may have it corrected.[4]

Under the acts of Congress the power to confirm or reject a sale belongs exclusively to the Circuit Courts of the United States. The powers conferred on the District Courts are only such as are necessary to control the ministerial duties of officers in the execution of final process.[5]

The court, by confirming a sale under a foreclosure decree which has been made by a sheriff on a day different from that designated in the decree of sale, will render the sale valid.[6]

[1] Pennsylvania Transportation Co.'s Appeal (1882), 101 Pa. St. 576.

[2] Turner *v.* Indianapolis, B. & W. Ry. Co. (1878), 8 Biss. 380.

[3] Pacific Railroad *v.* Ketchum (1879), 101 U. S. 289, 300.

[4] Blossom *v.* Railroad Co. (1865), 3 Wall. 196, 207.

[5] Milwaukee R. Co. *v.* Soutter (1866), 5 Wall. 660, 662.

[6] Farmers' Loan & Trust Co. *et al.* *v.* Oregon Pac. Ry. Co. *et al.* (Oregon, 1895), 40 Pac. Rep. 1089.

Statutes in some of the States relating to sales: Indiana, Rev. Stats. 1888, § 3941, Sale as an entirety. Kentucky, Gen. Stats. 1887, ch. 56, subd. iv., Judicial sales of such property. Michigan, How. Amer. Stats., § 3351, Sales under power. Mississippi, Rev. Code 1880, § 1038, Property and franchises salable under judgment. Ohio, Rev. Stats. 1890, § 3400, Property need not be appraised before foreclosure sale; upset price should be fixed; §§ 3420–3424, Conduct of sale. Texas, Sayle's Civ. Stats. 1888, § 4261, Conduct of sales under deed of trust or power. West Virginia, Code, ch. 54, § 72, Sale, purchaser.

CHAPTER XXXVI.

RIGHTS OF PURCHASERS AT A SALE OF THE MORTGAGED PROPERTY.

ARTICLE I. — EFFECT OF SALE AS REGARDS THE MORTGAGOR.

§ 799. **Corporation not dissolved by Sale.** — As was emphatically said in Atkinson *v.* Marietta & Cincinnati R. Co.,[1] "Although the corporation may be divested of its property, together with the franchise of operating and making profit from the use of its road, its corporate existence survives the wreck, and endures until the State sees fit to terminate it by proper proceedings."

The foreclosure of a railroad mortgage cuts off all the rights and interests of the mortgagor corporation in the mortgaged property, and leaves nothing for the stockholders except the surplus, if any, which remains after satisfying the mortgage and other preferential claims.[2]

But the corporation itself is not dissolved by the sale of its property.[3]

[1] 15 Ohio St. 21 (1864).

[2] Vatable *v.* New York, L. E. & W. R. Co. (1884), 96 N. Y. 49; s. c. 17 Am. & Eng. R. R. Cas. 268.

[3] Waterman on Corp., § 432.

Gulf, Colorado, & Santa Fé Ry. Co. *v.* Morris (1887), 67 Tex. 692. Compare Memphis & Little Rock R. Co. *v.* Railroad Commissioners (1884), 112 U. S. 609, where Mr. Justice Matthews, in the course of his opinion, adverted incidentally to the rule stated in the text as being well established. In Rogersville & Gt. Jefferson R. Co. *v.* Kyle (1882), 9 Lea (Tenn.), 691; s. c. 14 Am. & Eng. R. R. Cas. 576, it was, however, held that a decree which adjudged, among other things, that the lien of the State imposed by statute was superior to all claims whatsoever; that this lien extended to the road, its rolling-stock, and other property, rights, privileges, and franchises; and that upon a sale to any one but the original company, that company and its stockholders should cease to have any right, legal or equitable, in the property, rights, or franchises so sold, — had the effect of dissolving the original company when the subject-matter of the lien passed into the hands of a different company. "For all the practical purposes of its original creation," said the court, "the corporation ceased to exist. A corporation possessing neither property, rights, nor franchises is scarcely conceivable." This mode of arriving at a conclusion regarding the existence of a corporation under such circumstances seems rather lacking in precision. In view of the general principle stated in the text, the question seems to reduce itself simply to the inquiry, Did the franchise to be a corporation, as well as the other franchises, pass by the sale? If it did not, it must still exist somewhere, in the absence of some statute providing for such a case; and there is apparently no reason why the original company should not be regarded as still in possession of this rather barren privilege. Even under the Code of Tennessee a dissolved corporation may be continued in existence for the purpose of prosecuting and defending suits. The court, in deciding the above case, was largely influenced by the section of that Code (3431), declaring that "a corporation is not dissolved by mere non-

§ 800. **How far Rule is affected by Statutes permitting Purchasers to incorporate.** — The charter and franchises are not an incident which is annexed to and passes with a transfer of the property of the corporation, even though the legislature allows the purchasers to organize themselves into a new company, with all the rights, privileges, powers, and franchises of the former company. If such a transfer constitutes a cause of forfeiture for non-user, the forfeiture must be determined judicially to make it effectual.[1]

Nor does a special act incorporating the purchasers of an insolvent railroad, and investing them with "all the rights, powers, privileges, and franchises" of the former company, operate as a revocation of the charter of the latter. Such an act will be construed as a grant of only such rights, etc., as the legislature has the authority to grant; and it has no such authority in respect to the rights, etc., of the former company, unless they have been judicially declared forfeited, or revoked by an express enactment, which has that effect, and is not invalid as being repugnant to the constitution.[2]

Still less is the mortgagor corporation extinguished by an act declaring that the purchasers of a railroad, etc., at a judicial sale shall be and are thereby constituted a body politic and corporate, invested with the right, title, and interest of the former corporation in the property purchased, and also with the franchises existing at the time of the sale.[3]

§ 801. **Extent to which Liability of Mortgagor Company ceases with Foreclosure Sale.** — The mortgagor company is not liable for injuries resulting from the condition of the road after a foreclosure sale, and a purchase under an act declaring that the corporate rights and franchises should be as fully vested in the purchaser as if he had been the original corporator. Such a purchaser does not become identical with the company itself, so that by suit against the company his duties may be enforced. This being the case, the company is relieved of liability for the safety of those using the road, upon the general principle that, by the sale, its power over the road has entirely ceased, and with

user or assignment to others, in whole or in part, of its powers, franchises, and privileges, *unless* all the corporate property has been appropriated to the payment of its debts." Apart from this proviso, the case cannot be reconciled with the authorities cited under the present section.

1 Bruffett *v.* Great Western Railroad Co. (1861), 25 Ill. 353; Metz *v.* Buffalo, Corry, & Pittsburg R. Co. (1874), 58 N. Y. 61.

2 Wilmington R. Co. *v.* Downward (Del., 1888), 13 Centr. Rep. 284; s. c. 4 Ry. & Corp. L. J. 234.

3 Commonwealth *v.* Central Passenger Ry. Co. (1866), 52 Pa. St. 506.

its power its duty to keep the road in good condition has also terminated.[1]

The presumption is that the purchasers of a road who subsequently organize a new company are in possession of the property between the date of the sale and the time of filing the certificate of reorganization. The mortgagor company, therefore, is not liable for the operation of the road during that period, unless its possession is affirmatively shown.[2]

§ 802. **Effect of Sale upon Rights of Debtors and Creditors of Mortgagor Company.** — The continued existence of the corporation inures to the benefit of its creditors whose debts are unpaid at the time of the sale. Such creditors may still enforce their claims against the corporation, notwithstanding the surrender or sale of its corporate franchises.[3]

Thus, since the creditors of a railway company are entitled to consider an unconditional subscription, made by a municipality to aid the work of construction, as a part of the corporate assets as soon as it is granted, they may still enforce their right to the fund after the property and franchises have been sold and transferred by the legislature to a new company. The municipality, in such a case, has no power to donate a portion of the bonds issued on its subscription to the new company, except so far as the creditors of the old company will not be prejudiced by the donation.[4]

The creditors may enforce their claims by garnishment of the debtors of the corporation. Thus, when certain persons have subscribed for corporate stock, and then compromised a suit for the subscription by a contract to deliver cross-ties at a certain price, part of which is to be paid in stock and the remainder in cash, they are liable as garnishees to a judgment creditor whose

[1] Wellsborough & Tioga Plank Road Co. *v.* Griffin (1868), 57 Pa. St. 417, distinguishing Commononwealth *v.* Central Passenger Ry. Co. (1866), 52 Pa. St. 506, *supra*, decided with reference to another act.

[2] Pittsburg, Cincinnati, & St. Louis Ry. Co. *v.* Fierst (1880), 96 Pa. St. 144; s. c. 9 Am. & Eng. R. R. Cas. 437.

[3] Railroad Co. *v.* Howard (1868), 7 Wall. 392; Memphis & Little Rock R. Co. *v.* Railroad Commissioners (1884), 112 U. S. 609. In the latter case Justice Matthews refers with approval to the following words of the court in Coe *v.* Columbus, Piqua, & Indianapolis R. Co. (1859), 10 Ohio St. 372: "After an act of disposition which separates the franchise to maintain a railroad and make profit from its use from the franchise of being a corporation, though a judgment of dissolution may be authorized, yet until there be such judgment the rights of the corporators and of third persons may require that the corporation be considered as still existing."

[4] Morgan County *v.* Thomas, 76 Ill. 121 (1875), citing James V. Woodruff (1845), 2 Denio, 574.

execution against the corporate property has been returned *nulla bona.*[1]

But it has been held that, although the sale does not extinguish debts owing to the corporation, nor judgments of record in its favor, the corporation is dormant and incapable of action in regard to such debts and judgments, and is therefore incapable of conveying a judgment entered in its favor after the execution of the mortgage, and marked after the sale for the use of a new company organized by the purchasers.[2]

Article II. — Rights of Purchasers at Foreclosure Sales.

§ 803. **Purchaser bound by Decree.** — The purchaser at a foreclosure sale looks to the decree as the measure of his rights and liabilities, except in those cases where his position is defined by a general or special statute. The sale does not go beyond the decree. The purchaser takes nothing, acquires no rights, incurs no liabilities, except those which are determined and prescribed by the decree.[3]

Usually the decree is so worded as to make the subject-matter of the sale coextensive with that of the mortgage, and in this case the question, What passes to the purchaser? is evidently only another form of the question, — What does the mortgage cover? The decisions dealing with the effect of the mortgage in this respect, both from the point of view of the authority of the company to execute a mortgage of the thing specified, and also with reference to matters of mere construction, have been already discussed in a previous chapter, and need not be cited again. The same remark applies where a statutory lien is declared in favor of the State, and enforced by appropriate proceedings. The purchaser at the sale acquires the various kinds of property covered by the lien, — no more, no less. For a discussion of the scope of those liens the practitioner is referred to an earlier portion of this treatise.

§ 804. **What passes to Purchaser at Trustee's Sale.** — Property which is mentioned neither in the decree directing, nor the advertisement announcing, a trustee's sale, will not pass to the purchaser, although that property constitutes a part of the security of the bondholders.[4]

1 Smith *v.* Gower (1865), 2 Duv. (Ky.) 17.

2 Wilmington R. Co. *v.* Downward (Del. 1888), 13 Centr. Rep. 284.

3 Simmons *v.* Taylor (1885), 23 Fed. Rep. 849. See generally, as to this principle, Rorer on Railroads, 921.

4 Osterber *v.* Union Trust Co. (1876), 93 U. S. 424. The rule was here applied

A notice of sale must be reasonably specific as regards the subject-matter to be disposed of, and the purchasers will acquire nothing except what is described with sufficient particularity to indicate the value of the property to intending bidders. A covenant in favor of the mortgagor company does not pass to the purchaser under a trustee's notice of sale which designates the subject-matter of the sale as the "property, rights, privileges, and franchises, things in action, and other things described in the mortgage, as appears in the bill filed by the complainant."[1]

§ 805. **Right to Municipal Aid does not pass Foreclosure Sale.** — Until a company to which aid has been voted by a municipality occupies a position which will enable it to enforce whatever right or interest it may have in the appropriation, such an appropriation is not a *chose in action* which can be mortgaged, so as to pass the right to enforce it to a purchaser at the foreclosure sale.[2]

§ 806. **Purchaser's Right to Earnings of Road accumulated in Receiver's Hands.** — The purchaser is not entitled to money accumulated in the receiver's hands, as the net income of the road from the date of the decree of foreclosure to the date of the sale. Those earnings are the property, not of the company, but of its creditors, and should be applied by the court to the payment of their claims according to their priorities.[3]

to funds coming into the receiver's hands from the sales of land assigned by the company to trustees.

[1] Milwaukee & St. Paul R. Co. *v.* Milwaukee & Minnesota R. Co. (1865), 20 Wis. 165, 174. The court said: "Is it permissible that *choses in action*, instruments in writing, should thus be exposed for sale and swept away in this loose and uncertain manner? What purchaser could bid understandingly when property is thus offered for sale without any designation or description? Obviously a bidder could not know, and would have no means of ascertaining, whether the *choses in action* were worth a thousand, a hundred thousand, or a million of dollars. The mortgage being recorded as a real-estate, and not a chattel mortgage, would probably not be even constructive notice to third persons as to the property covered by it. No person, therefore, attending the sale could know what price to bid or how to regulate his judgment if there was no specific and certain designation of the property offered for sale. . . . A sale at auction and upon notice implies that there is some designation of the thing offered to be sold, so that persons whom the law invites to such auction may be able to know where and what is the property they are about to purchase."

[2] Board of Commrs. of Hamilton County *v.* State, *ex rel.* Cottingham (1888), 115 Ind. 64; s. c. 4 N. E. Rep. 589; 17 N. E. Rep. 855.

[3] Strang *v.* Montgomery & Eufaula R. Co. (1879), 3 Woods, 613; Osterber *v.* Union Trust Co. (1876), 93 U. S. 424. In the former case the court also held that, even if the purchaser had a right to such earnings on general principles, yet he could not claim them under the decree in question, which directed a sale of the "road, franchises, right of way, depots, rolling-stock, tools, and all other property

The purchasers under the foreclosure of a junior mortgage, consummated while a receiver appointed at the instance of a senior mortgagee is in possession, have an equity to the earnings accumulated in such receiver's hands which is superior to that of the stockholders and unsecured creditors, and a bill by the latter to hold the receiver to an accounting for those earnings will be dismissed upon demurrer.[1]

Where the property of a railroad company is sold under foreclosure of a junior mortgage, subject to the rights of prior mortgagees under a mortgage of the "net income," and under its provisions the trustee of the bondholders in case of default foreclosed, and the property went into the possession of the same receiver as in the prior suit, the purchaser at the sale acquires no right to the income during the receivership. It belongs to the holders of the prior mortgage bonds.[2]

§ 807. **Right to use Lands appropriated by Company not lost by Non-use of Mortgagor Company's Franchises.** — The right of a purchaser to use the land appropriated by the mortgagor company cannot be impugned by showing that the latter had, by non-use and failure to construct its road, forfeited its franchises. Such a default can only be taken advantage of by the State.[3]

What passes under the word "franchises" generally, see the chapter on Definitions *sub voc.*

So far as the answer to this question depends on the *power* to mortgage franchises, Chapter VII. should be consulted.

§ 808. **Statutory Right to regulate Tolls does not pass.** — The benefit of a statutory right to regulate tolls, conferred upon a company, cannot be claimed by a purchasing company organized under a statute which provides that it shall be subject to all the laws of the State which apply to railroad corporations generally, and there has been passed, subsequently to the enactment of the statute conferring the privilege on the former company, a statute prescribing what rates of toll may be charged by railroad companies.[4]

§ 809. **Exemption from Taxation sometimes passes to Purchaser.** — Exemption from taxation will not pass to the purchaser at a

of the company, real, personal, and mixed." Such a decree does not cover any personalty except the rolling-stock and other property placed on the road by the receiver in the discharge of his duty to carry on the business of the company.

[1] Lafayette Co. *v.* Neely (1884), 21 Fed. Rep. 738; s. c. 17 Am. & Eng. R. R. Cas. 242.

[2] Downs *v.* Farmers' Loan & Trust Co. (1897), 79 Fed. Rep. 215.

[3] Logan *v.* Vernon, Greensburg, & Rushville R. Co. (1883), 90 Ind. 552; s. c. 14 Am. & Eng. R. R. Cas. 43.

[4] Norfolk & Western R. Co. *v.* Pendleton (1890), 86 Va. 1004; s. c. 11 S. E. Rep. 1062.

sale under a decree covering all the mortgaged property of a railroad company, including the "franchises." [1]

Nor will the use of the word "privileges" in the mortgage enlarge the rights of the purchasers in this respect.[2]

A foreclosure sale under a mortgage of the "charter" of the company is equally ineffective to transfer this privilege to the purchasers.[3]

So also, though the mortgage professes to transfer the charter, the rights of a railroad company to have the damages for the appropriation of its land assessed in a particular manner is a personal privilege of the grantee, and does not pass to purchasers incorporating under a general law which transfers to it the "property and franchises" of the mortgagor.[4]

§ 810. **The same Principle of Construction is applied where the Rights of Purchasers are defined by Statute.** — "Exemption from taxation," it is declared, "must be construed to have been the personal privilege of the very corporation specifically referred to, and to have perished with that, unless the express and clear intention of the law requires the exemption to pass as a continuing franchise to a successor. This salutary rule of interpretation being founded on an obvious public policy which regards such exemptions as in derogation of the sovereign authority and

[1] Morgan *v.* Louisiana (1876), 93 U. S. 217. In this case Justice Field, on page 223, said: The term "franchises" "is often used as synonymous with rights, privileges, and immunities, though of a personal and temporary character, so that if any one of them exista it is loosely termed a 'franchise,' and is supposed to pass upon a transfer of the franchises of the company. But the term must always be considered in connection with the corporation or property to which it is alleged to appertain. The franchises of a railroad corporation are rights or privileges which are essential to the operations of the corporation, and without which its road and works would be of little value; such as the franchise to run cars, to take tolls, to appropriate earth and gravel for the bed of its road, or water for its engines, and the like. They are positive rights or privileges, without the possession of which the road of the company could not be successfully worked." See also, to the same effect, Railroad Co. *v.* County of Hamblen (1880), 102 U. S. 273; Louisville & Nashville R. Co. *v.* Palmes (1883), 109 U. S. 244, 252; s. c. 13 Am. & Eng. R. R. Cas. 380; Chesapeake & Ohio Ry. Co. *v.* Miller (1885), 114 U. S. 176.

[2] Picard *v.* East Tenn., Va. & Ga. R. Co. (1889), 130 U. S. 637.

[3] Memphis & Little Rock R. Co. *v.* Railroad Commissioners (1884), 112 U. S. 609.

[4] Little Rock & Fort Smith Ry. *v.* McGehee (1883), 41 Ark. 202; s. c. 10 Am. & Eng. R. R. Cas. 82. Compare Dow *v.* Beidleman (1887), 49 Ark. 325, where it was held that, under such a mortgage, a provision in the charter that the charge for carrying passengers should not exceed five cents per mile for each passenger, even if it could be construed as a contract on the part of the State that passenger fare would not be reduced below that rate, would not have the effect of transferring the privilege to the purchasers, since their reorganization under a constitution enacted since the granting of the original charter created a new corporation subject to legislative control.

of common right, and therefore not to be extended beyond the exact and express requirement of the grants, construed *strictissimi juris*." [1]

In applying this principle the courts, with one or two exceptions, have taken the position that the exemption will not pass by any word which does not constitute an apt description of this privilege as distinguished from others. Thus it has been held by the Supreme Court of the United States that the exemption will not pass by a charter granting to a railroad company all the "rights, powers, and privileges" of another company.[2]

In Kentucky, also, it has been held that the purchasing company will not enjoy an exemption from taxation conferred on the mortgagor, merely for the reason that the legislature has recognized by the recitals of the statute the fact that the "rights, franchises, and property" of the latter have passed by the sale.[3]

In Florida, on the other hand, the view is taken that the right of exemption from taxation can be passed under the general language "all the rights," as well as any other.[4]

That the use of the word "immunities" will carry an exemption from taxation in all cases seems to be a legitimate inference from several cases. In some of these, however, the courts were influenced more or less strongly by other considerations which were deemed to support the inference that this was the intention of the legislature. Thus it has been held that an act providing for the sale of a road which the State itself has bought in foreclosure proceedings to enforce its lien, and conferring on the purchasers "all the rights, franchises, privileges, and *immunities*" of the defaulting corporation, will cover any exemption from taxation that the latter may have possessed, providing the

[1] Memphis & Little Rock R. Co. *v.* Railroad Commissioners (1884), 112 U. S. 609.

[2] Railroad Companies *v.* Gaines (1878), 97 U. S. 697; Wilson *v.* Gaines (1877), 9 Baxt. (Tenn.) 546, affirmed in Wilson *v.* Gaines (1880), 103 U. S. 417. This case came before the Supreme Court of the United States on demurrer to a bill praying that the collection of taxes on the property be restrained, and averring that the sale was under the proceedings to enforce a statutory mortgage in favor of the State. The court held that, as the question was presented in this manner, it could not, in the absence of a particular allegation to the contrary, presume that the sale embraced anything not covered by the lien. The authority of Morgan *v.* Louisiana, *supra*, was, therefore, controlling.

[3] Evansville, Henderson, & Nashville R. Co. *v.* Commonwealth (1872), 9 Bush (Ky.), 438.

[4] Atlantic & Gulf R. Co. *v.* Allen (1876), 15 Fla. 637. The words used were "rights, franchises, and privileges," but no stress was laid on the addition of the last two. Trask *v.* Maguire, *infra*, was cited as an authority for this doctrine; but it is clearly not in point, for the statute there construed included the significant word "*immunities*."

legislature has the power, when the act is passed, to exempt railroad property from taxation.[1]

So also in the same light the Supreme Court of the United States has viewed an act incorporating a company and empowering it to acquire by purchase all the "property, rights, privileges, franchises, and immunities."[2]

So, where a statute empowers a new company to take a conveyance from an old one of "all its franchises, rights, powers, privileges, and immunities," the conveyance will operate as a transfer of any immunity from taxation possessed by the old company.[3]

In Kentucky the same construction has been placed upon a statute providing that the purchaser or lessee of a road should be vested with all the "rights, privileges, franchises, and immunities" of the mortgagor company.[4]

[1] Trask *v.* Maguire (1873), 18 Wall. 391. In this case such an exemption was held to be unconstitutional. The theory adopted by the court was that when the State purchased the railroad, the immunity necessarily ceased, so that the validity of the grant of exemption was to be tested by the constitution in force at the time when the new company acquired its rights. That such a merger of the exemption may be prevented by a clear expression of the legislature to that effect has been held in First Div. of St. Paul & Pac. R. Co. *v.* Parcher (1869), 14 Minn. 297, decided in view of the contemporaneous policy of encouraging railroad building in thinly peopled districts. The court deemed itself justified in holding, for this reason, that there was no merger of the exemption when the State acquired the property, and that its grantees were not affected by a constitutional provision forbidding such exemptions which had been passed since the rights of the first company had become vested.

[2] Louisville & Nashville R. Co. *v.* Palmes (1883), 109 U. S. 244, 252; s. c. 13 Am. & Eng. R. R. Cas. 380. The court said: "The language is comprehensive and unequivocal, and the word 'immunity' is apt to describe the exemption claimed." In this case, however, the question was whether the company, whose powers and rights were thus defined by the statute, could, by a conveyance describing the subject-matter of the assignment in the same words as the statute, carry to its grantee this immunity from taxation, and the court, on the authority of Morgan *v.* Louisiana, held that the conveyance had no such effect.

[3] Nichols, Treasurer, etc. *v.* New Haven & Northampton Company (1875), 42 Conn. 103. The court pointed out that the people of the State, owing to the insolvency of the first company, had not as yet received the benefit from the canal which had induced the legislature to grant the original exemption. The inevitable inference, therefore, was that the intention of the legislature was to continue the exemption in the new company in order to do justice to the creditors whose money had been expended in the enterprise, and to induce persons to subscribe to the cash capital of the corporation. And such was the import of the provision, that the new corporations should have "all the *immunities* of the old corporations." This language could have no other meaning than that the immunity from taxation to be enjoyed by the new company should be coextensive with that enjoyed by the old. Philips, J., dissented, on the ground that "the extinction of the stock of the old company carried with it the extinction of the privilege."

[4] Commonwealth *v.* Owensboro & Nashville R. Co. (1884), 81 Ky. 572; s. c. 17 Am. & Eng. R. R. Cas. 428.

The court distinguished Morgan *v.* Louisiana, but it is not very clear from

So also in Tennessee it has been held that, where the legislature by a special act invested a certain chancery court with exclusive jurisdiction to determine all questions arising out of the foreclosure proceedings instituted to enforce the lien of the State upon the railroads which had received its aid, and a decree of that court adjudged, in the words of the act, that the property of one of the delinquent companies, and also "all its rights, franchises, privileges, and immunities," should pass to the purchasing company, the latter acquires the same privilege of exemption from taxation which was enjoyed by the old company.[1]

The Supreme Court of Minnesota has also declared that exemption from taxation passes to purchasers who, by statute, are invested with the "privileges, grants, franchises, immunities, and advantages" of the mortgagor. Such an exemption, it was said, was not distinguished from any of the other rights

the opinion what the precise ground of the decision was. Neither Trask *v.* Maguire nor Louisville & Nashville R. Co. *v.* Palmes, *supra*, were cited, though exactly in point. The essence of the ruling is contained in the following sentence: "We find in this case not only legislative authority to make the transfer, but, as an inducement to the purchasers to make their bids, it is expressly provided that the immunity from taxation shall follow the road in the hands of those who buy it." The words "from taxation" are not found in the statute as quoted, and we are left to assume that the court regarded the word "immunities" as wide enough to include "immunity from taxation." Yet the same court, a few years later, without referring to this case, ruled that a statute incorporating purchasers, and investing them with the "powers, rights, privileges, immunities, and franchises" of the mortgagor company, did not exempt the new corporation from taxation, or carry to it the privilege of having its stock assessed in a peculiar manner. Kentucky Central R. Co. *v.* Commonwealth (1888), 87 Ky. 661; s. c. 10 S. W. Rep. 269; 5 Ry. & Corp. L. J. 293. It is not easy to see how these two cases can be reconciled.

[1] Knoxville & Ohio R. Co. *v.* Hicks (1877), 9 Baxt. (Tenn.) 442; s. c. 15 Am. Ry. Rep. 197. In this case, however, the court did not lay any special stress on the use of the word "immunities," as it took occasion to dissent from the ruling of Morgan *v.* Louisiana, then recently decided. The broad ground was taken that the exemption was a part of the charter, and could not be repealed by the legislature, whether the road was in the hands of the original company or its successor. This court adhered to its opinion in State *v.* Nashville, Chattanooga, & St. Louis Ry. Co. (1883), 12 Lea (Tenn.), 583; s. c. 17 Am. & Eng. R. R. Cas. 420. But in this latter case express reference was made to Trask *v.* Maguire (1873), 18 Wall. 405, as an authority for the proposition that "immunity" includes exemption from taxation, — a consideration not relied upon in the first case, but, as we venture to think, the only one on which that decision can be sustained. The simple question involved in all such cases is, What was the intention of the legislature? If the purchasers suffer by wrongly interpreting that intention, they are merely in the position of any one else who is mistaken about the meaning of the law. The point raised as to the inability of the legislature to withdraw the privilege seems quite irrelevant so far as the purchasers are concerned, for they take exactly what the law allows them, — no more, no less. If there is any impairment of the contract, that is a matter between the State and the original company.

granted, and was certainly comprehended in the description contained in the statute. Even if the immunity were not a franchise, in the legitimate sense of the word, it was a right, a contract right, to hold the property exempt from taxation until the same were sold and conveyed. Not being a personal or inalienable right, there was no reason why it should not pass with the property, and as appendant thereto, to the purchaser. When the company lost the property, it lost that right, for it lost that to which the right related.[1]

In South Carolina the broad ground has been taken that a statutory exemption from taxation is not a mere personal privilege which ends with the first taker, provided the property is continued in the same use on account of which the exemption was granted.[2]

§ 811. **Vested Rights of Purchasers cannot be impaired by Subsequent Legislation.** — If the purchasers at a trustees' sale acquire, by virtue of the laws in force at the time of the sale, a valid title to the corporate property without liability for any of its debts which were not a prior lien on that property, their rights cannot be taken away or impaired by subsequent legislation.[3]

Article III. — Liabilities of Purchasers at Foreclosure Sales.

§ 812. **Generally.** — In the absence of some enactment by which the purchasers at a foreclosure sale of the rights, privileges, franchises, and other property of a railroad company become, by virtue of such purchase, a corporation, they are regarded merely as joint owners of the property so acquired. The immunity of the members of the corporation from liability for its debts beyond the amount of stock which they individually hold does not pass by such a sale, and the purchasers are, therefore, subject to whatever responsibility the law attaches to the joint ownership of railroad property. Thus it has been held in

[1] First Div. of St. Paul & Pacific R. Co. *v.* Parcher (1869), 14 Minn. 297. Here, it will be observed, the reasoning is quite general, and not made to depend on any special signification of the word "immunities." The case was decided before Morgan *v.* Louisiana, as was also Chicago, Milwaukee, & St. Paul R. Co. *v.* Pfaender (1877), 23 Minn. 217, reiterating the same doctrine.

[2] Hand *v.* Savannah & Charleston R. Co. (1881), 17 S. C. 219, 280; s. c. 12 Am. & Eng. R.R. Cas. 495. The court, curiously enough, does not refer to Morgan *v.* Louisiana, or any other of the cases previously decided in regard to this point.

[3] Hatcher *v.* Toledo, Wabash, & Western R. Co. (1872), 62 Ill. 477.

Louisiana, where the law makes obligors engaged in carrying personal property for hire liable *in solido*, only when it is carried on ships or other vessels, such stockholders of the company as may become purchasers of a railroad are liable individually for a proportionate share of a debt evidenced by the making of a promissory note purporting to be executed as an obligation of the former company. The fact that the instrument is drawn in this shape does not protect them, for obligors are bound, not by the style which they give to themselves, but by the consequences they incur by reason of their acts. Nor can their liability be modified by an act of incorporation passed after the issuance of the instrument, for the rights of the holder are then vested and cannot be effected by legislation.[1]

(a) *Purchaser takes free from Subsequent Liens.* — A purchaser takes the property, real and personal, free from all subsequent liens and incumbrances, and his title, for the purpose of cutting off such liens, will relate back to the date of the record of the mortgage.[2]

Thus one who purchases the property before the rendition of a judgment against the latter takes it free from the lien of such judgment, although the judgment creditor obtains no part of the proceeds of the sale, because of his failure to make proper application to the court for payment.[3]

The practical application of this principle will be determined not merely by the date of the execution and registration of the mortgage, but by the extent of the lien established by the after-acquired property, as a lien upon property which comes under the protection of that clause does not attach to that property in the hands of the purchaser.[4] What property is covered by that clause has been fully discussed in a previous chapter.

(b) *Purchaser sometimes takes free from Liens held by Persons not Actual Parties.* — A purchaser of railroad property on foreclosure takes it discharged of all liens and interests acquired pending the suit by persons charged with constructive notice thereof, although they were not made parties to the suit; and the latter must seek satisfaction out of the proceeds of the sale.[5]

[1] Chaffe *v.* Ludeling (1875), 27 La. Ann. 607.

[2] Cooper *v.* Corbin (1883), 105 Ill. 224; s. c. 13 Am. & Eng. R. R. Cas. 394.

[3] Brockert *v.* Iowa Central R. Co. (Iowa, 1895), 61 N. W. Rep. 405.

[4] See, for example, Bell *v.* Chicago, St. Louis, & New Orleans R. Co. (1882), 34 La. Ann. 785, where the purchaser was held to take property of this description free from the apparent incumbrance of a registered judgment lien.

[5] Stewart *v.* Wheeling & L. R. Ry. Co. (Ohio, 1895), 41 N. E. Rep. 247.

(c) *Purchaser takes free from Liens which he had a Right to suppose discharged.* — Where the trustee enters a release of the trust deed, in pursuance of an arrangement by which there is to be another issue of bonds in lieu of those secured by the deed, the presumption is that all the former bonds are cancelled, and a purchaser of the property at a subsequent assignee's sale in bankruptcy will take it free from the incumbrance of a bond not exchanged, unless he has notice that it was not paid and the release was wrongfully executed, or knew of facts sufficient to put him on inquiry.[1]

(d) *Purchaser takes free from Tax Lien sometimes.* — In Illinois, under the statute which provides that "the taxes assessed upon personal property shall be a lien upon the personal property of the person assessed from and after the tax books are received by the collector," it has been held that the tax lien does not attach to the property, unless it belongs to the debtor at the time the tax books came into the hands of the collector. That lien will, therefore, be defeated by a valid mortgage or sale made before that time, and proceedings to enforce it will be enjoined at the instance of the person holding under such mortgage or sale.[2]

(e) *Purchaser takes subject to Liens absolutely paramount by Statute.* — Where the effect of a statute conferring special rights on a contractor is to give him a paramount lien on the property, as long as his debt remains unsatisfied, the lien will not be divested by a subsequent foreclosure sale, "subject to any law claims or rights which may exist prior or paramount to the mortgage."[3]

So also the purchasers will be liable for the amount of a judgment for personal injuries which is a paramount lien by virtue

[1] Burt *v.* Batavia Paper Mfg. Co. (1877), 86 Ill. 66. It was here held that, even if some of the members of the new company formed from the purchasers did know that one of the bonds had not been paid when the new organization was effected, yet if they also knew that a new bond was issued in place of the former, and interest paid thereon after the adjudication in bankruptcy, there being nothing to show but that it was paid on the new bond, this was not sufficient to put the new company on inquiry as to the existence of the lien of the bond.

[2] Binkert *v.* Wabash Ry. Co. (1881), 98 Ill. 205. In Cooper *v.* Corbin (1883), 105 Ill. 224, the same doctrine was again announced, the court holding that where the capital stock of a railroad company, at the time when the tax became a lien thereon, was already subject to the prior lien of a mortgage, the tax lien would attach only to the company's equity of redemption, and that when that equity was cut off by a foreclosure sale, the purchaser took the property free from any lien from the tax.

[3] Fox *v.* Seal (1874), 22 Wall. 424. The statute here under consideration was the Pennsylvania Resolution of 1843, the substance of which is given in Chapter V.

of a statute prohibiting railroad companies from creating mortgage liens which shall be superior to such judgments,[1] or to maintain highway crossings in good condition.[2]

(f) *Purchaser takes subject to Statutory Obligations as to Operation of Road.* — Obligations imposed by statute upon every company operating a railroad as a part of its duties to the State, or some political division thereof, are, of course, binding on purchasers at a foreclosure sale. Thus they are liable for the non-performance of a statutory duty to keep bridges in repair.[3]

(g) *Purchaser takes subject to Obligations and Restrictions imposed by Charter on Mortgagor Company.* — A section in a railroad company's charter, authorizing a purchase of its property and franchises by another company, and providing that the purchase thus authorized shall "in no way affect the rights of the creditors of the company," is presumed to have been introduced for the benefit chiefly of unsecured creditors, persons to whom such a provision may be of advantage, rather than for those whose claims are protected by deeds creating specific liens. The effect of the provision, therefore, is to create a trust in favor of the unsecured creditors which may be enforced against the property, even when it has passed into the hands of persons who have purchased it at a foreclosure sale, in proceedings taken to enforce a mortgage executed by the vendors of the original company.[4]

So also it is held that a restriction as to the right to fix tolls, imposed upon the old corporation, as a condition of obtaining State aid, inheres in its organic law precisely as if incorporated therein, and is therefore binding upon the new corporation.[5]

§ 813. **Contracts of Mortgagor Company are not, as a General Rule, binding on its Successors.** — Thus an agreement entered into by the mortgagor not to build through a city so as to connect with another line is a mere personal contract, and does not bind its successor, or prevent it from making the connection, provided it does not exceed its corporate powers in so doing.[6]

[1] Frazier *v.* East Tennessee, V. & G. R. Co. (1889), 88 Tenn. 138 ; s. c. 12 S.W. Rep. 537 ; 40 Am. & Eng. R. R. Cas. 358.

[2] Gage *v.* Pontiac, Oxford, & Northern R. Co. (1895), 105 Mich. 335 ; s. c. 63 N. W. Rep. 318.

[3] New York & Greenwood Lake R. Co. *v.* State (1888), 50 N. J. L. 303 ; s. c. 13 Atl. Rep. 1.

[4] Montgomery & West Point R. Co. *v.* Branch (1877), 59 Ala. 139.

[5] Mobile & Montgomery R. Co. *v.* Steiner (1878), 61 Ala. 559.

[6] City of Menasha *v.* Milwaukee & Northern R. Co. (1881), 52 Wis. 414 ; s. c. 5 Am. & Eng. R. R. Cas. 300.

For a case in which a contract of a somewhat complicated character was held to be a mere personal agreement, creating no lien on the property, see Peninsular Iron Co. *v.* Eells (1895), 68 Fed. Rep. 24.

Apart from those cases in which a contract of the mortgagor is assumed by the purchaser, either *proprio motu*, or for the reason that his rights are defined by a decree requiring its performance (see *post*), or a trust is involved (see § 816, *post*), such a contract is not obligatory on the purchaser, unless it has either been secured by a lien,[1] or runs with the land,[2] or it must have been adopted as to its benefits, so as to preclude the purchaser from declining its burdens.[3]

Where the bondholders were purchasers of railroad property under a reorganization scheme which gave them all the benefits of the receivership at the time of the filing as well as after the filing of the bill to foreclose, and it expressly stipulated in the decree of sale, as well as in the decree confirming the sale, that the purchasers should take the property subject to all the receivership debts, such purchasers will be held liable for a rental claim of a leased line, during the operation of it by the receiver.[4]

Where the final decree in a foreclosure proceeding provides that the purchasers shall pay all subsisting liens upon the property which have priority to the mortgage, the purchasers will be held liable for all those liens which have been recognized by the court in the proceedings; and if, under a decree of the court, a sale of any of the property covered by the mortgage takes place to satisfy a recognized prior lien, the same purchasers buy it in, they will be considered as having redeemed

[1] Newport & Cincinnati Bridge Co. *v.* Douglass (1877), 12 Bush, 673; s. c. 18 Am. Ry. Rep. 221.

[2] Wiggins Ferry Co. *v.* Ohio & Mississippi R. Co. (1892), 142 U. S. 396; s. c. 12 Sup. Ct. Rep. 188; 94 Ill. 83 (1879), where it was held that a covenant that a railroad company would always employ a ferry company to transport for it all persons and property across the Mississippi River, was not a covenant running with the land.

So a covenant to pay rent is one which binds the purchaser. Frank *v.* New York, Lake Erie, & W. R. Co. (1890), 122 N. Y. 197; s. c. 25 N. E. Rep. 332; 46 Am. & Eng. R. R. Cas. 356.

A railroad company that has purchased at a foreclosure sale a road, a part of which was constructed and put into operation with money raised by taxes voted by a town, assumes the obligation of the former company, and cannot lease that part of the road to another company so as to surrender the exclusive use thereof, and by ceasing to operate it deprive such town of the benefits intended to be derived from such operation, when the aid was voted to the original company. This obligation to operate the road is more than a debt. It inheres in the franchise, so to speak, and pertains to the right to operate the road. It does not pass by an assignment proper; it passes to the grantee as a burden or limitation upon the rights to operate the road. State *v.* Central Iowa Ry. Co. (1887), 71 Iowa, 410; s. c. 32 N. W. Rep. 409.

[3] South Carolina R. Co. *v.* Wilmington, Columbia, & Augusta R. Co. (1875), 7 S. C. 410.

[4] Central R. & Banking Co. of Georgia *v.* Farmers' Loan & Trust Co. (1897), 79 Fed. Rep. 158.

the property in the interest of those holding recognized liens upon it still unpaid [1]

§ 814. **Trust availing against Purchaser avails against his Assignee.** — A trust to which the property is subject in the hands of a purchaser at the foreclosure sale will attach to the property in the hands of an assignee with express or implied notice thereof. Thus where the trustee has purchased the road pursuant to an agreement with the majority of the bondholders that they are to receive their proportion of the proceeds in the form of bonds of a reorganized company to be formed to take over the property, and the president of the company to which the resale is made has knowledge of the trust, that company will be directed to execute and deliver, within a certain period, bonds such as are called for by the original plan of reorganization, and upon its refusing or neglecting to do so will be ordered to pay the *cestuis que trust* the money value of the bonds.[2]

§ 815. **Purchasers take subject to Vendor's Lien, when.** — The purchasers take subject to a vendor's lien of which they have notice, such a lien being regarded as an equitable mortgage,[3] but are not personally liable for the mortgage debt or the interest thereon. Nor can they be held for the rents accruing prior to a demand on them for the possession of the property or the appointment of a receiver.[4]

A vendor's lien in favor of the trustees is not lost because the company organized by the purchasers consolidates with another company. The consolidated body is not, under such circumstances, a *bona fide* purchaser.[5]

§ 816. **Assumption of Obligations inferred from Fact of Purchase under a given Decree.** — It has been already stated that the purchaser looks to the decree as the measure of his rights. The decree is also the measure of his liabilities. So an order directing possession of a railroad to be delivered by a receiver to a purchaser, subject to the payment of such claims against the receiver as may be established within a reasonable time, before the court which appointed him, does not make the purchaser liable for any claims that are not established in accordance with such order.[6]

[1] Sheffield & B. Coal, Iron, & Ry. Co. *v.* Newman (1896), 77 Fed. Rep. 787.

[2] Indiana, Illinois, & Iowa R. Co. *v.* Swannell (1895), 157 Ill. 616; s. c. 41 N. E. Rep. 989.

[3] Hall *v.* Mobile & Montgomery Ry. Co. (1877), 58 Ala. 10.

[4] Ibid.

[5] Schutte *v.* Florida Central R. Co. (1879), 3 Woods, 691.

[6] Houston & T. C. R. Co. *v.* Crawford (Tex., 1895), 31 S. W. Rep. 176; s. c. 28 L. R. A. 761.

This general principle is a protection to the purchaser in those cases where an attempt is made to saddle him with the payment of claims which the decree does not require him to satisfy. It is held that a foreclosure sale, when confirmed by the court, and its conditions met by the purchaser, creates, in effect, a contract between the court and the purchaser, and that the court can no more impose an additional term or condition on that contract than an individual can. Hence if the decree directs that the property be sold, discharged of all liens and claims against the company or its receivers, the court has no power to direct the purchaser to pay a claim which was adjudicated against the receiver after the confirmation of the sale.[1]

Nor can the holders of underlying mortgages which are not mentioned in the decree among the preferred debts obtain an order requiring the payment of their mortgages by the purchasers, before the latter enter into possession. To grant such an order would materially modify the provisions of the decree under which the purchasers bought the property, thus in effect compelling them to take it on terms differing from those proposed at the time of the sale, and to do this, moreover, after the contract of sale is partially executed.[2]

So a lease entered into by the mortgagor pending a foreclosure suit is not binding on a company which purchases under a decree providing that it should be at liberty to abandon any contracts made by the mortgagor after the institution of the proceedings. The right of the purchaser to disclaim such a lease is not affected by the fact that the receiver appointed in the suit has adopted the contract and accepted rent from the lessee.[3]

Where the effect of the final decree in a foreclosure suit is to vest in the purchaser a title free of all liens for receiver's debts, it operates so as to set aside *pro tanto* a previous order making receiver's certificates, to be issued, a paramount lien on the road, and transfer the lien, if any, to the proceeds of the sale.[4]

The same principle also inures to the disadvantage of the purchasers. After accepting their conveyance, they have no standing in court for the purpose of re-litigating the liens subject to which they have taken their title.[5]

[1] Chicago & O. R. Co. *v.* McCammon (1894), 61 Fed. Rep. 772.

[2] Central Trust Co. *v.* Wabash, St. Louis, & Pac. Ry. Co. (1887), 30 Fed. Rep. 332.

[3] Farmers' Loan & Trust Co. *v.* Chicago & A. R. Co. (1890), 44 Fed. Rep. 653.

[4] Mercantile Trust Co. *v.* Kanawha & O. R. Co. (1893), 58 Fed. Rep. 6.

[5] Swann *v.* Wright's Exrs. (1884), 110 U. S. 590.

Thus, the purchasers cannot contest the validity of receiver's certificates or the amount for which they are declared by the decree to be a lien on the property.[1]

So if the decree makes them liable to "pay all debts and liabilities of the receivership of every kind," they are liable for the death of a horse caused, during the receivership, by the defective condition of the roadway which the receiver was bound to keep safe for travellers.[2]

The decree, however, will not operate as notice of any antagonistic claims except those which are designated with reasonable certainty. Thus it is very doubtful whether a clause approving the deed to the purchasers, to the effect that nothing therein "shall at any time be construed to affect or impair in any way or manner the rights of any person or corporation claiming to hold stock, whether common or preferred, in the first-named (mortgagor) company, or of any person or corporation not a party to this suit," can be deemed to affect the purchasers with notice of certain claims of a minority of the stockholders.[3]

The purchaser's liability for certain debts may also be predicated as a necessary implication from the terms of the decree without their being expressly provided for. Thus the effect of a decree which provides that the creditors of the mortgagor company are to receive the stock of the new company in payment of their claims, is that the latter company is to be liable for the debts of its predecessor.[4]

So, if the decree contains no foreclosure of a certain junior mortgage, the rights secured thereby are unaffected by the sale, and the purchaser takes the property subject to the holder's

[1] Swann *v.* Wright's Exrs. (1883), 110 U. S. 590; Central National Bank *v.* Hazard (1887), 30 Fed. Rep. 484; St. Louis S. W. R. Co. *v.* Stark (1893), 55 Fed. Rep. 758.

[2] Wabash R. Co. *v.* Stewart (1891), 41 Ill. App. 640.

[3] Boston & Providence R. Corporation *v.* New York & New England R. Co. (1881), 13 R. I. 260; s. c. 2 Am. & Eng. R. R. Cas. 300. The court did not pass directly upon the sufficiency of the notice; as, whatever was its effect, it had come too late, but remarked as follows: "Assuming that the provision in the decree was a notice, what could the purchasers have ascertained if they had undertaken to investigate the matter. Could they have ever found that the alleged ownership of the second corporation had ever been disputed; that anything had been done to set aside the sale, or that any person or corporation claiming to hold stock, whether common or preferred, in the first corporation, had in any way during the twelve years shown any dissent otherwise than by the fact that some had not taken pay for their stock? Was there any notice that the complainant had ever made, or intended to make, any claim of ownership in the property?"

[4] Wood *v.* Dubuque & S. C. R. Co., 1 Ry. & Corp. L. J. 68 (1886), 28 Fed. Rep. 910; s. c. 1 Ry. & Corp. L. J. 68.

right of redemption, especially when they do not allege a purchase made in ignorance, and do not offer to surrender the property to be resold for the benefit primarily of the first lienholders.[1]

§ 817. **Purchaser affected with Notice of Proceedings in Foreclosure Suit.** — A purchaser must take notice of all petitions filed during the foreclosure suit by those who seek to establish liens superior to the mortgage. Thus where it is decided, by proceedings in intervention, that the lien of a mortgage with the after-acquired clause is, as regards certain rolling-stock, subordinate to the lien reserved by the vendors, the bondholders cannot object either to the restoration of the case or to the payment of the price from the fund in court, if that course is preferred by the vendor.[2]

So also the purchaser is affected with notice of proceedings to enforce a vendor's lien on real estate, whether those proceedings are had in the same court as that in which the foreclosure suit was brought, or, by the permission of that court, in another tribunal.[3]

§ 818. **Liability of Purchaser by Reason of its Occupation of Land acquired by Mortgagor.** — Where it is provided by the constitution of a State that the compensation for land taken shall be paid before the taking, a railroad company, with an outstanding mortgage on its property, which occupies lands for which damages have been assessed but not paid, has no interest in such land for the mortgage to operate upon, and a sale under the mortgage will not convey the title nor extinguish the lien for damages. The right to the damages is paramount to the lien of the mortgage, and until the damages are paid or secured that right cannot be extinguished by a foreclosure sale.[4]

Such a right, therefore, is covered by a decree which directs the sale to be made subject to any legal claims or rights which may exist prior to or paramount to the mortgage.[5] In Massachusetts also it is held that a person whose land is taken by a railroad corporation, under the right of eminent domain, has a right to compensation which, if not strictly a lien, is at least

[1] Simmons *v.* Taylor (1885), 23 Fed. Rep. 849.

[2] Fosdick *v.* Car Co. (1879), 99 U. S. 256.

[3] Loomis *v.* Davenport & St. Paul R. Co. (1882), 3 McCrary, 489.

[4] Western Pennsylvania R. Co. *v.* Johnston (1868), 59 Pa. St. 290; Buffalo, New York, & Philadelphia R. Co. *v.* Harvey (1884). 107 Pa. St. 319; s. c. 26 Am. & Eng. R. R. Cas. 642; White *v.* Nashville & N. W. R. Co. (1872), 7 Heisk. (Tenn.) 518.

[5] Wheeling, P. & B. R. Co. *v.* Warrell (1888), 122 Pa. St. 613; s. c. 16 Atl. Rep. 20.

in the nature of a lien or incumbrance on the land; and this right may be enforced against a corporation which succeeds the corporation taking the land.[1]

The rule is otherwise where the company has given the statutory bond for payment of the damages ultimately assessed. The original owner is then relegated to his rights under the bond.[2]

But until the damages assessed are paid or secured to the land-owner, he can enjoin the new company from further maintaining and operating its road over the right of way occupied.[3]

This liability of the purchaser for the value of the land appropriated by the mortgagor is not changed by the fact that a new company organized after foreclosure to operate the line of the insolvent mortgagor company is not liable for the general debts of the latter except those which are assumed. If a judgment for the price against the old company remains unsatisfied at the time of the sale, and the new company enters upon and occupies the land, equity will hold it liable for the payment of the price, on the principle that it has adopted and ratified the original appropriation. *Qui sentit commodum sentire debet et onus.*[4]

Nor does he, by suing for damages, concede that the company has acquired the easement of the right of way, but merely that it is entitled to that easement, upon condition that it pays

[1] Drury *v.* Midland R. Co. (1879), 127 Mass. 571.

[2] Fries *v.* Southern Pennsylvania R. & Mining Co. (1877), 85 Pa. St. 73; s. c. 18 Am. Ry. Rep. 375.

[3] Gilman *v.* Sheboygan & Fond du Lac R. Co. (1876), 40 Wis. 653; Drury *v.* Midland R. Co. (1879), 127 Mass. 571.

[4] Lake Erie & Western Ry. Co. *v.* Griffin (1883), 92 Ind. 487; Pfeifer *v.* Sheboygan & Fond du Lac R. Co. (1864), 18 Wis. 155; Gilman *v.* Sheboygan & Fond du Lac R. Co. (1876), 40 Wis. 653; s. c. 13 Am. Ry. Rep. 468. In the last case the court said: "The right of the land-owner to compensation for his property is protected by the constitution, and must prevail even as against the purchasers. It appears from the complaint that the old company is wholly insolvent, has really ceased to exist as an organized corporation, that all its franchises and property have passed to, and are now held by, the defendant as its successor. The judgment against the corporation is consequently absolutely worthless, and unless the plaintiff can have some relief against, at least, the new company, either by a suit in this form or by an action at law, he is entirely remediless. And the fact that the old company has ceased to exist is a sufficient answer to the objection that it should have been made a party defendant. We are merely unable to perceive upon the facts stated any grounds for saying that the plaintiff has waived or lost his right to payment from the defendant if it continues to use his lands. It is true it appears that the foreclosure sale took place about two years after final entry of judgment for damages against the old company. But the purchaser at that sale took under the purchase only such rights as that proceeding gave him. The old company had then acquired no rights to use the land for its road, but was in possession simply as a trespasser. The plaintiff's right to compensation is paramount, and not affected or destroyed by the foreclosure."

him such compensatory damages as may be assessed by the court.[1]

When the purchasers occupy and use land which the mortgagor company had agreed to pay for by the construction of the road, the fencing of the track, and the building of a crossing, and the last two conditions have not been performed by either company, the purchaser is liable in damages, measured by the difference in the rental value of the property caused by such non-performance, and the judgment for such damages constitutes a lien on the portion of the road located on the land covered by the contract.[2]

Similarly the purchaser cannot claim the right to use a depot under a contract made by the mortgagor after the execution of the mortgage, without payment of the rental provided for in the contract.[3]

The liability created in such cases as the above is to be distinguished from that which results from the rendition of a judgment in an action of trespass to recover damages sustained by the construction and operation of the road on the land. Such a judgment imposes no obligation on a purchaser who takes by virtue of a decree declaring him to be liable for "all unpaid claims of landowners for damages for property taken, injured, or destroyed by the construction," but stands on the same legal footing, as regards him, with any other judgment against the mortgagor for a tort.[4] (See § 820, *post.*)

Similarly, where the consideration for an agreement junior to the mortgage, whereby it is sought to impose upon the land taken for the right of way a burden not necessary for the proper construction and operation of the road, is merely a claim for damages, such an agreement imposes no obligation upon the purchasers at the foreclosure sale.[5]

§ 819. **Assumption of Obligations inferred from Agreements of New Company or its Transferrers.** — The general rule as to the non-liability of the new company may be superseded by special contract, as where it agrees to assume some or all of the general debts of its predecessor.[6]

[1] Rio Grande & E. P. R. Co. *v.* Ortiz (1890), 75 Tex. 602; s. c. 12 S. W. Rep. 1129; 44 Am. & Eng. R. R. Cas. 67.

[2] Varner *v.* St. Louis & C. R. Co. (1881), 55 Iowa, 677.

[3] St. Joseph Union Depot Co. *v.* Chicago, R. I. & Pac. R. Co. (1895), 131 Mo. 291; s. c. 31 S. W. Rep. 908.

[4] Campbell *v.* Pittsburgh & W. R. Co. (1890), 137 Pa. St. 574; s. c. 20 Atl. Rep. 949; 46 Am. & Eng. R. R. Cas. 353, distinguishing Western Pennsylvania Co. *v.* Johnston, 59 Pa. St. 290, *supra.*

[5] Hunter *v.* Burlington, C. R. & N. R. Co. (1889), 76 Iowa, 490; s. c. 41 N. W. Rep. 305.

[6] Lake Erie & Western Ry. Co. *v.* Griffin (1883), 92 Ind. 487; s. c. 17 Am. & Eng. R. R. Cas. 235.

So, also, a new company which acquires title to the property by a conveyance thereof from the purchasing committee in return for its stock, after that committee has assented through its representatives to the creation of a lien on the property, is bound by the lien. It is not a purchaser for value being affected by the notice imparted to the committee.[1]

But an agreement which merely preserves to the old unsecured creditors the right to come in as stockholders of the new company will not make the latter liable for their claims.[2]

Nor can the principle that the property of the old company is a trust fund for its creditors operate so as to fasten a liability for its debts upon the purchasing company, where the latter acquires that property in adversary proceedings; and an agreement by which the stockholders of the old company are to be permitted to become members of the new one is entered into *after* the rights acquired by the purchase have fully vested.[3]

Where, in a suit to foreclose two junior mortgages, the purchasers buy the property subject to the lien of a first mortgage executed to secure a county for the loan of its aid bonds, and the proceeds of the sale are partly applied to redeem some of those bonds which had been hypothecated, the purchasers are not entitled to such redeemed bonds, unless they first refund to the general creditors as much of the proceeds as went to redeem them.[4]

§ 820. **Purchaser not generally liable for Mortgagor's Torts in Operation of Road.** — The purchaser is not liable for damages caused by the mortgagor's operation of the road, unless there is some special statute which produces that result (see § 812*f*, *ante*,

[1] Vilas *v.* Page (1887), 106 N. Y. 439; s. c. 13 N. E. Rep. 743.

A party in possession under the express terms of an order of sale, and representing all parties in interest, cannot claim to be an absolute purchaser of the rights of a mortgagor, not subject to account for rents and profits. Compton *v.* Jesup (1897), 167 U. S. 1.

[2] Smith *v.* Chicago & Prairie du Chien Ry. Co. (1863), 18 Wis. 17.

[3] Stewart's App. (1872), 72 Pa. St. 291, distinguishing Railroad Co. *v.* Howard (1868), 7 Wall. 392, where there was a preliminary agreement for the benefit of the stockholders, and their equities were held to be inferior to those of the creditors.

[4] Washington, O. & W. R. Co. *v.* Lewis (1887), 83 Va. 246; s. c. 2 S. E. Rep. 746. The court said: "The lien to secure bonds having been expressly reserved at the sale, and assumed by the purchasers, their obligation as to all is the same; that is, to step into the place of the old company. In doing this they are not required to pay more than the price they agreed to pay. They agreed to pay the purchase price, and assume the liabilities, whatever they were, as to the preferred lien, and this is all they have been required to do. Their money was used to redeem these bonds, when they acquired the purchased property. The purchase-money did not belong to them. It stood in the place of the property they had purchased. Their agreement was to buy the property of the first company, subject to the obligations of the first lien, and to this alone they have been held."

for an example of such a statute), or he has assumed these debts with others. Thus a company organized by the purchasers of a boom company's property is not liable for injuries caused by obstructions placed in a river by the mortgagor company, unless it has notice of their existence, and thus becomes itself a tort feasor in not removing them.[1]

Nor is the purchaser answerable for the consequences of his predecessor's negligence,[2] nor for a trespass committed by such predecessor.[3]

§ 821. **Liability of New Company for Damages caused by Operation of Road by Trustees.** — A claim for damages to property by fire communicated by a locomotive, while passing along its track at a time when the road was in possession of and operated by the trustees, does not depend upon proof of malfeasance or negligence, but is an incident to the running of the road, and may be considered a part of the running expenses. It is, therefore, an equitable lien on the funds of the trustees; and if they convey to a new corporation, formed of the bondholders, any funds subject to that lien, the new corporation will be liable in equity to the person suffering the damage.[4]

§ 822. **Liability of Purchasers for Damages caused by Operation of Road by Receiver.** — Where the receiver of a railroad devotes the income to permanent improvements, claims arising out of the operation of the road, whether in contract or in tort, and left unpaid because of such diversion of the income, are among the liabilities which the purchaser must discharge.[5]

Purchasers at foreclosure sale of a railroad which has been improved by the receiver by the expenditure of money out of its earnings will be liable for the obligations incurred by the receiver during the receivership to the extent of such improvements.[6]

[1] Neff *v.* Wolf River Boom Co. (1880), 50 Wis. 585.

The Nebraska statute of 1881 as to the purchase of railroads by other companies expressly provides that the purchaser "shall be subject to any and all liens, incumbrances, or indebtedness" existing against the railroad company from which the purchase is made. See Chicago, St. P. M. & O. R. Co. *v.* Lundstrom (1886), 16 Neb. 254; s. c. 20 N. W. Rep. 198; 21 Am. & Eng. R. R. Cas. 529.

[2] Louisville & Nashville R. Co. *v.* Orr (1891), 91 Ky. 109; s. c. 15 S. W. Rep. 8; 9 Ry. & Corp. L. J. 189.

[3] Campbell *v.* Pittsburgh & W. R. Co. (1890), 137 Pa. St. 574; s. c. 20 Atl. Rep. 949; 46 Am. & Eng. R. R. Cas. 353; Hammond *v.* Port Royal & Augusta Ry. Co. (1880), 15 S. C. 10; s. c. 11 Am. & Eng. R. R. Cas. 353.

[4] Stratton *v.* European & North American Ry. Co. (1884), 76 Me. 269; s. c. 17 Am. & Eng. R. R. Cas. 277.

[5] Houston & Texas Central R. Co. *v.* Crawford (1895), 88 Tex. 277; s. c. 28 L. R. A. 761; 31 S. W. Rep. 176; Ryan *v.* Hays (1884), 62 Tex. 42; s. c. 23 Am. & Eng. R. R. Cas. 501.

[6] Missouri, K. & T. Ry. Co. of Texas *v.* Lacy *et al.* (Tex. Civ. App., 1896), 35 S. W. Rep. 505.

Extent of purchaser's liability when railroad is sold under foreclosure proceed-

Personal injuries caused by negligence of the employees of a receiver operating a railroad constitute a cause of action against the receiver, and a judgment in such an action will bind the property in the hands of a purchaser at foreclosure sale, where the order of the court confirming the sale orders such claims paid; such claims partake of the nature of operating expenses of the property.[1]

When a receiver, subsequent to the sale of a railroad, under a decree of a federal court has made betterments upon it exceeding in value all liabilities imposed upon the purchaser in the decree for sale, the purchaser may be held liable to the extent of such excess for negligence of the receiver occurring subsequent to the sale of the property.[2]

§ 823. **No Liability attaches to Purchaser until Sale is confirmed.** — Until the sale is confirmed, no liability attaches to the purchasers for injuries caused by the operation of the road, for, until the property is actually conveyed to them, they have no right to intermeddle with it. Up to the time of the confirmation those operating the road are in no sense their employees, or subject in any way to their control.[3]

§ 824. **Purchasers organizing as a New Company not liable for Debts of Mortgagor.** — The principles illustrated in the preceding sections are not, as a general rule, affected by the statutes which provide that the purchasers at a mortgage sale of the property and franchises of an existing company may organize anew, and be invested with all the rights and powers of the old company in the management of the road and the business. The new companies are not, in the absence of some provision to that effect, or some special consideration which would impose an obligation on a purchaser independently of statute, liable for the debts of the mortgagor.[4]

ings and left in the hands of receiver to be operated for torts. See Houston & Texas Central Ry. Co. *v.* Strycharski (Tex. Civ. App., 1896), 35 S. W. Rep. 851.

[1] St. Louis S. W. Ry. Co. *v.* Holbrook (1896), 73 Fed. Rep. 112.

[2] Houston & Texas Central Ry. Co. *v.* Kelly (Tex. Civ. App., 1896), 35 S. W. Rep. 878. See Houston & Texas Central Ry. Co. *v.* Crawford (1895), 88 Tex. 277; s. c. 31 S. W. Rep. 176; Houston, E. & W. T. Ry. Co. *v.* Keller (Tex. Civ. App., 1896), 36 S. W. Rep. 859; Houston, E. & W. T. Ry. Co. *v.* Keller (1894), 8 Tex. Civ. App. 537; Chicago & Erie R. Co. *v.* Towle (1894), 10 Ind. App. 540.

A receiver continuing to operate the road after foreclosure sale and conveyance to the purchaser, the latter has been held liable to a shipper of goods for loss during the operation of the road by the receiver, in Houston & Tex. Central Ry. Co. *v.* McFadden (Tex. Civ. App., 1897), 40 S. W. Rep. 216.

[3] Metz *v.* Buffalo, Corry, & Pittsburg R. C. (1874), 58 N. Y. 61.

[4] Lake Erie & W. Ry. Co. *v.* Griffin (1883), 92 Ind. 487; Cook *v.* Detroit, etc. Ry. Co. (1882), 43 Mich. 349; s. c. 9

Such a company, unless there is some express provision to that effect in the statute under which it is organized, does not acquire the corporate entity of the mortgagor. A different doctrine would clearly render these statutes of little utility, and entirely defeat the very policy which the legislature has sought to carry out by their enactment.[1]

They operate not as a revival of the old corporation, but as the creation of a new one.[2]

Such statutes do no injustice to general creditors.[3]

This is the effect even where the enabling statute authorizes the purchasers to "reorganize" the former company "as a new corporation" under the same name as the mortgagor.[4]

To make the new company liable for any claims against the old one, in addition to those which are paramount to the mortgage, the act must expressly provide that the stockholders in the

Am. & Eng. R. R. Cas. 443; Vilas *v.* Milwaukee & Prairie du Chien Ry. Co. (1863), 17 Wis. 497. In the last case the court said: "The object of the law was to enable railroad companies to borrow money, and to mortgage their property and franchises as security. To give full and perfect effect to such mortgages as securities was the leading idea of the law. To accomplish it, the company was authorized to mortgage its franchises; and, for the purpose of removing all doubt, it was further expressly provided that the purchasers at a mortgage sale might organize anew, and be invested with all the rights and powers of the old company in the management of the road and business. Without some such provision a purchase of the property would be unavailing. The same powers are conferred not with a view to a continuation of the same corporation, but to give full effect and protection to rights created by the mortgage adverse to those of the old corporation. To say, therefore, that because the purchasers have the same powers, they are in effect the same corporations, would be to defeat the primary object of the law, and to destroy the interests of the mortgagee. His interest, and all the proceedings to protect those interested, are adverse to the original corporation. And it is this adverse character which excludes the idea that the proceeding has no other effect than merely to continue the old corporation, and which so plainly distinguishes the case from those mere changes of corporate names or powers, where the principle relied on by the plaintiff has been held applicable, that it is difficult to imagine that they could ever have been confounded. The law shows plainly that it was intended that such mortgages should have effect like other mortgages, according to their priority; and it certainly would have been idle to expect to obtain loans upon such securities if it had been otherwise. Yet the doctrine here contended for would destroy all priority, and the purchaser under the prior mortgage could take the property and franchises of the company with a liability to pay not only the subsequent mortgages, but all its unsecured debts."

[1] Metz *v.* Buffalo, Corry, & Pittsburg R. Co. (1874), 58 N. Y. 61, distinguishing Commonwealth *v.* Central Pass. Ry. (1866), 52 Pa. St. 506, decided with reference to a statute of a different tenor, and following Wellsboro & Tioga Plank Road Co. *v.* Griffin (1868), 57 Pa. St. 417, decided under the law as it was before the passage of that statute.

[2] Huff *v.* Winona & St. Peter R. Co. (1866), 11 Minn. 180.

[3] Cook *v.* Detroit, G. H. & M. R. Co. (1882), 43 Mich. 349; s. c. 5 N. W. Rep. 390; 9 Am. & Eng. R. R. Cas. 443.

[4] Marshall *v.* Western North Carolina R. Co. (1885), 92 N. C. 322; s. c. 20 Am. & Eng. R. R. Cas. 578.

old company shall be stockholders in the new one, or that the latter shall be liable for the debts of the former,[1] or use some language which indicates an intention that the usual rule shall not govern the rights of the parties. The fact that the incorporation of the new company takes place under an act which uses the word "reorganization" in the title does not create any privity between it and its predecessors, when, by the terms of that act, the new company cannot come into existence except upon the contingency of the foreclosure sale.[2]

In some States, as in Michigan, the purchasers are expressly freed by the terms of the statute from liability for any debts embraced in the foreclosure, and it is held that such a statute does no injustice to general creditors.[3]

Where the statute providing for reorganization expressly declares that the new corporation formed from the purchasers of the road shall not be liable for any debts except those subsequently contracted by it, and leaves all property not embraced in the foreclosure sale liable for existing debts, a common-law action cannot be maintained against that corporation. If any property not purchased on the foreclosure is in the possession of the new company, application for relief must be made to a court of equity.[4]

§ 825. **The Right of Redemption.** — The right to redeem is a right incident to every mortgage and every instrument or transaction intended as a security, regardless of its actual form. It is a right that exists independently of agreement between parties, for it is a creature of the law.[5]

Speaking generally, all equitable right of redemption is barred by a foreclosure sale, for "the right to foreclose means the right to cut off a right to redeem given by equity, when by the condition of the mortgage the mortgagee's estate has become absolute at law."[6]

A statute which in terms destroys or impairs a right of redemption established as a vested right under the general law is unconstitutional.[7]

The right may be lost by laches, independently of the bar of any statute of limitations.[8]

[1] Morgan County *v.* Thomas (1875), 76 Ill. 120.

[2] Stewart's App. (1872), 72 Pa. St. 291.

[3] Cook *v.* Detroit, G. H. & M. R. Co. (1882), 43 Mich. 349; s. c. 5 N. W. Rep. 390; 9 Am. & Eng. R. R. Cas. 443.

[4] Ibid.

[5] Kerr's Supp. to Wiltsie on Mortgage Foreclosure, pp. 1495–1498.

[6] Holmes, J., in Shepard *v.* Richardson (1887), 145 Mass. 36.

[7] The Ashuelot Ry. Co. *v.* Elliot (1873), 52 N. H. 387.

[8] Simmons *v.* Burlington, etc. Ry. Co. (1895), 159 U. S. 278.

The right of redemption after sale is regulated by statute in many States. The federal courts recognize these statutes as controlling, and a State statute, therefore, which allows any particular period to redeem after foreclosure and sale is regarded and treated in the federal courts as a rule of property.[1]

But these statutes do not apply to railroad mortgages covering all the property in different States as an entirety.[2]

A mortgage is personal property, and follows its owner. Wherefore a suit to redeem the land, which is the suject of the mortgage, must be brought where jurisdiction *in personam* may be had, without reference to the *situs* of the land.[3]

A purchaser, under an execution sale, of a right to redeem a portion of railroad property situated in a particular State is entitled also to redeem the whole road, including property in another State; but, to save a forfeiture, he must pay all that is presently due. Then he will be placed in the position of the mortgagors, and the right of redemption will not be foreclosed. The trustees of the mortgage will hold possession, but must account for the earnings; and if those earnings, together with the purchaser's payment to the trustees, are sufficient to discharge the bonds, the purchaser will be entitled to possession.[4]

In a suit to foreclose, if the decree orders a sale of the property to pay the mortgage debt, an express order cutting off the equity of redemption of a junior mortgagee, although a party to the suit, is not necessary as an invariable rule, — certainly not, where there is a prayer that he be directed to redeem, where the priority of the plaintiff's mortgage is found or conceded, where a sale is ordered in default of payment, and where the right of the debtor to redeem is declared forever barred. The junior mortgagee has, of course, a right to redeem without such order; but if he chooses not to assert it, standing by while the sale is made and confirmed, he must be deemed to have waived the right.[5]

The right of a junior mortgagee, who has not been made a party in proceedings to foreclose a prior mortgage, to redeem the mortgaged premises is barred within the period within which his right to foreclose would be barred, — namely, ten years.[6]

A demurrer to a bill for redemption was sustained in the Su-

[1] Brine *v.* Ins. Co. (1877), 96 U. S. 627.

[2] Turner *v.* Indianapolis, B. & W. Ry. Co., 8 Biss. 381.

[3] The Kanawha Coal Co. *v.* The Kanawha & Ohio Coal Co. (1870), 7 Blatch. 415.

[4] Wood *v.* Goodwin (1861), 49 Me. 260.

[5] Simmons *v.* Burlington, C. & R. & N. Ry. Co. (1895), 16 Sup. Court Reporter, U. S. 1.

[6] Gower *v.* Winchester (1871), 33 Iowa, 303.

preme Court of Maine upon the grounds, first, of a misjoinder of parties plaintiff, the court holding that stockholders should not have been joined with the corporation unless fraud on the part of the latter was alleged, for so long as the corporation is faithful to its trust, the stockholders, as individuals, have no right or standing to take action to protect the corporate interests and property; second, the bill was defective in omitting to charge that the defendant in possession held the mortgage title; and, third, that the bill should have averred an offer to pay such amount as might be found due.[1]

A judgment in a debenture-holder's action to foreclose should provide that moneys accumulated in the hands of a receiver, who had carried on the business of the defaulting company at a profit, should be applied towards payment of the amount due.[2]

[1] Kennebec & Portland Ry. Co. *v.* Portland & Kennebec Ry. Co. (1866), 54 Me. 173.

[2] Cumming *v.* Metcalfe's London Hydro (1895), 13 Rep. 501.

CHAPTER XXXVII.

REMEDIES IN CASES OF OBJECTIONS TO SALES.

Article I. — Stay of Sales by Injunction.

§ 826. **When Injunction will be granted.** — Whether an injunction against a sale shall be refused or allowed is often merely another form of the question whether the mortgage is valid or invalid. (See Chapter VII.)

§ 827. **Sale not restrained merely because Mortgagee had no Right to make it.** — The company cannot procure an injunction to stay a sale by virtue of a power in a mortgage executed to a contractor to secure bonds issued to him in payment of construction, where the ground for the application is merely that the mortgagee has no right to make the sale.[1]

§ 828. **Sale not restrained if Defendant capable of responding in Damages.** — The fact that the guarantor of bonds who has stipulated to complete the mortgagor's road has not performed his contract, is not a sufficient reason for restraining the trustee of a mortgage of indemnity, given to such guarantor to secure him against loss, when the latter is solvent and capable of responding in damages, unless it appears that the default for which the sale is impending will be cancelled by the amount of the bonds still on deposit, added to the amount of the damages which may be awarded. Especially will such an application be denied when the mortgagor, though bound to keep down the interest on its outstanding bonds, has failed to do so, and suffered the loss to fall on the guarantor. The mortgagor, under such circumstances, is not in a favorable position to complain of the guarantor's delay in prosecuting the work of construction.[2]

§ 829. **Trustee's Sale not restrained merely because Amount of Bonds justly due has not been ascertained.** — Where the sale is being made under the power in the mortgage which makes it the *duty* of the trustee to sell upon receiving a request to that effect from a majority in interest of the bondholders, it has been held that the sale will not be delayed until it has been ascertained how many of the bonds are justly due. Each bondholder, it is said, holds his own bonds separately and independently of all the others; and when his interest remains in arrear, under the circumstances mentioned in the trust deed, he ought not to be delayed by a controversy as to the validity of the bonds held by other persons.[3]

[1] York & Cumberland R. Co. *v.* Myers (1856), 4 Me. 109. The court said: "But the plaintiffs say that the deed gives him [the defendant] no such authority. If so, then the defendant's deed would convey nothing, and no injury could be by them sustained. Again, the plaintiffs apprehend that some innocent purchaser may be ruined. It may be so, but such anticipation does not enlarge our equity powers, and it is not to be presumed that the maxim of *caveat emptor* has lost its force and influence."

[2] Macon & Augusta R. Co. *v.* Georgia Railroad & Bkg. Co. (1879), 63 Ga. 103; s. c. 1 Am. & Eng. R. R. Cas. 378.

[3] State *v.* Brown (1885), 64 Md. 199. The court expressly distinguished this case from proceedings in foreclosure, in which it was declared to be necessary to ascertain the amount of the debt, so that the defendant may know how much it is

§ 830. **Sale under Power in Mortgage securing Bonds issued by Directors to themselves will be restrained.** — An issue of bonds by the directors to themselves as a gratuity being *ultra vires* and void, an injunction will be granted to restrain a sale under a power in the mortgage securing bonds so issued and held by one who knew that they were not sold to obtain a working capital, or to pay a corporate debt, but as the private property of the president.[1]

§ 831. **Sale restrained if Default caused by Misconduct of Debtor's Agents.** — An injunction will be granted to stay a sale for arrears of interest on State-aid bonds secured by a statutory lien, where it appears that the State officials have neglected the duty imposed upon them of investing a previous payment made by the company, and that the amount which such investment would have realized exceeds the arrears due upon the bonds.[2]

§ 832. **Sale when not restrained at Instance of Junior Incumbrances.** — A junior mortgagee not a party to the suit cannot enjoin a foreclosure sale, as it will not, under such circumstances, affect his rights, and he may at any time exercise his right of redemption.[3]

Still less will such an injunction be granted where the sale is made in a statutory proceeding, and its effect is to extinguish the rights of the junior lienors entirely.[4]

A State in whose favor a statutory lien was declared upon a railroad, as a security for a loan, cannot enjoin a sale under a power in a trust deed executed to secure an issue of bonds, in accordance with an act construed as evincing an intention on the part of the State to subordinate its own rights to those acquired under the trust deed.[5]

The holders of receiver's certificates, authorized during fore closure proceedings, are privies to a decree on an intervention in the same proceedings in favor of the holder of a mechanic's lien as a first subsisting lien against the property, directing its pay-

necessary for him to pay in order to prevent the sale. The ruling was based strictly upon the fact that the agreement of the parties, as expressed in the trust deed, must be carried out. The question was not considered with reference to the danger which the uncertainty as to the amount of the claims would have in deterring bids. Such uncertainty is considered a good ground for *postponing* a foreclosure sale, or a sale under power, until controversies are settled. It would seem that it ought not to be a sufficient reason for restraining a sale also.

[1] Virginia Tide-Water Coal Co. *v.* Mercantile Trust Co. (1890), 58 Hun, 610 (mem.); s. c. 35 N. Y. St. Repr. 141; 12 N. Y. Supp. 529.

[2] Ralston *v.* Crittenden (1882), 13 Fed. Rep. 508.

[3] Searles *v.* Jacksonville, P. & M. R. Co. (1873), 2 Woods, 621.

[4] Ibid.

[5] Brown *v.* State (1884), 62 Md. 439.

ment, or in default a sale, and are not entitled to an injunction restraining the carrying out of such a decree.[1]

Nor will a court, at the instance of the trustee of a junior mortgage, enjoin a sale to satisfy a prior statutory mortgage, or appoint a receiver to take charge of the property, and, out of the earnings, reimburse the trustee, stockholders, and bondholders, in case they should pay the amount of the decree, when the disproportion between the value of the property and that amount precludes the idea that any one will be permitted to purchase the property discharged from a trust in favor of the holders of stock and bonds. The presumption, in such a case, is that the directorate, whose duty it is to protect the interests of the stockholders, will not incur the liability which a neglect of that duty will impose, and if they are guilty of such neglect, the bondholders and other parties in interest have the means of protecting themselves from any loss. Even if the decree is not satisfied, it may be anticipated with certainty that the property will be bought by or for the company, or by or for some one or more of the holders of stock or bonds. Such a decree, therefore, does not menace the interests of the bondholders with any danger which warrants a court in delaying the sale.[2]

Article II. — Setting aside Foreclosure Sales.[3]

§ 833. **Methods of Procedure to vacate Sales.** — Under the equity rules of the federal courts, final decrees may be modified or set aside in one of three modes: (1) By appeal within the time prescribed by law. (2) By bill of review filed within the time allowed by law for an appeal charging error apparent on the record. (3) By original bill charging fraud or newly discovered evidence. Bondholders who contest the validity of a final decree in a foreclosure suit by the second of these methods

[1] Gordon *v.* Newman (1894), 62 Fed. Rep. 686. In this case, the trustee of bondholders, named in the trust deed, had instituted foreclosure proceedings. G., the holder of a mechanic's lien upon a part of the property, intervened, and there was a decree in his favor, directing the payment of the amount, or, in default, a sale of the property, recognizing it as a first subsisting lien. Subsequent to the intervention, an issue of receiver's certificates was authorized. In the final decree of foreclosure, a sale was ordered, subject to all liens, and especially declaring these certificates to be among the liens to be paid, as against the mortgages. The holder of certain of these certificates was granted an injunction restraining the enforcement of the decree in favor of G., the holder of the mechanic's lien, in the Circuit Court, but the injunction was dissolved on appeal in the Circuit Court of Appeals for that circuit.

[2] Overton *v.* Memphis & Little Rock R. Co. (1882), 10 Fed. Rep. 866, per Caldwell, D. J.

[3] See Rorer on Railroads, 921 ; Wood's Ry. Law, 1637.

are concluded by adverse decision of the Supreme Court, and the only course open to them, if they have any right to assert, is to seek relief by an independent and original proceeding; but in such a proceeding they cannot assert any rights in hostility to, or inconsistent with, the adjudication already had.[1]

Ordinarily, where bondholders seek to annul a decree and sale on the ground of the fraud of the trustees, the proper practice is to file a bill in the nature of an original bill or bill of review, and to apply to be made parties to the original foreclosure suit, and then seek to controvert matters which were errors in the proceedings.[2]

Under such circumstances the proceedings to obtain relief are equivalent to a bill in equity to set aside the decree on the ground of fraud, and constitute a new and original proceeding.[3]

But where the right to make any further orders has been reserved in an order confirming the sale, a bondholder who seeks relief against the sale and its confirmation should be admitted by petition to the original suit, and have his objections examined.[4]

§ 834. **Who may except to Sale.** — A stockholder,[5] or any one who had an interest in the subject-matter at the time of the sale and its confirmation, has a standing in court to object afterwards to the validity of the proceedings; but those who had no such interest cannot be permitted to disturb what the parties who were interested have acquiesced in.[6]

Decrees ordering sales, therefore, cannot be assailed by persons who have purchased bonds after the completion of sale. Such an assignment does not carry with it a right of action to impeach the proceedings.[7]

[1] Huntington *v.* Little Rock & Fort Smith Ry. Co. (1882), 16 Fed. Rep. 906; s. c. 3 McCrary, 581.

[2] Wetmore *v.* St. Paul & Pacific R. Co. (1880), 3 Fed. Rep. 177. 182; Richter *v.* Jerome (1887), 123 U. S. 247; Meyer *v.* Utah & Pr. Ry. Co. (1883), 3 Utah, 280.

In Pacific R. Co. *v.* Missouri Pac. Ry. Co. (1881), 2 McCrary, 231, stockholders brought suit to have a decree set aside on the ground that the corporate officers had been guilty of bad faith in the conduct of the suit. The court remarked that it was either an original bill to impeach a decree for fraud, or a bill of review on newly discovered facts and evidence; but considered it to be the former, saying at the same time that if it was the latter, it was clearly bad, because filed too late, and also because filed without the leave of the court.

[3] Sahlgaard *v.* Kennedy (1880), 2 Fed. Rep. 295.

[4] Wetmore *v.* St. Paul & Pacific R. Co. (1880), 3 Fed. Rep. 177.

[5] Graham *v.* Boston, Hartford, & Erie R. Co. (1886), 118 U. S. 161; Foster *v.* Mansfield, C. & L. M. R. Co. (1888), 36 Fed. Rep. 627. In the last-named case relief was refused on the ground of the petitioner's laches.

[6] *Ex parte* Fleming (1864), 2 Wall. 759, 762.

[7] Sahlgaard *v.* Kennedy (1882), 13 Fed. Rep. 249.

Nor will the sale be opened at the instance of a purchaser at a receiver's sale, who, on the ground of the interest thereby acquired, was admitted a defendant in a suit to foreclose a first mortgage, with no right but that of appearing at the taking of the account of the sum due on the mortgage, and of being notified of the taking of such account; but who, before the master's report was made, had lost all his interest in the mortgaged premises, by reason of a sale thereof under foreclosure of a second mortgage, where the sole ground of his application is that he was not notified of the taking of the account. Any interest which such a person may have by reason of his ownership of bonds secured by the mortgage foreclosed can be protected by proceedings to prevent injustice in the distribution of the proceeds of the sale.[1]

The effect of the rule that the acts of the trustees bind those whom they represent, is considered in another chapter.

§ 835. **Right to Relief as affected by Laches of Petitioner.** — Want of diligence in the petitioner in seeking relief against a sale will sometimes be a decisive ground for denying application.

Every case is governed chiefly by its own circumstances: sometimes the analogy of the Statute of Limitations is applied; sometimes a longer period than that prescribed by the statute is required; in some cases a shorter time is sufficient; and sometimes the rule is applied where there is no statutable bar. It is competent for the court to apply the inherent principles of its own system of jurisprudence and to decree accordingly.[2]

A delay of seventeen years in moving to enforce claims embodied in an agreement of a company with preferred stockholders, the corporate property having in the meantime been transferred to a new company by a foreclosure sale, will fully warrant the application of the rule of laches.[3]

For the same reasons, where a foreclosure has become absolute for seven years the court will refuse to entertain an application from the stockholders to set aside the sale on the ground of

[1] Ward *v.* Montclair Ry. Co. (1875), 26 N. J. Eq. 260.

[2] Sullivan *v.* Portland & Kennebec R. Co. (1876), 94 U. S. 806, citing the following familiar passage from Smith *v.* Clay, Ambler, 645: "A court of equity which is never active in giving relief against conscience or public convenience, has always refused its aid to State demands where a party has slept upon his rights and acquiesced for a great length of time. Nothing can call forth this court into activity but conscience, good faith, and reasonable diligence. Where these are wanting, the court is passive, and does nothing. Laches and neglect are always discountenanced, and, therefore, from the beginning of this jurisdiction there was always a limitation to suits in this court."

[3] Sullivan *v.* Portland & Kennebec R. Co. (1876), 94 U. S. 806.

fraud, where everything which was done in the proceedings alleged to be fraudulent might at any time have been ascertained by them, if they had seen fit to examine the records.[1]

A petition of stockholders to have a foreclosure sale set aside for fraud will be dismissed where it is filed five years after the sale, and the petitioners do not allege when they discovered the fraud, nor give a satisfactory reason why their knowledge was not sooner obtained.[2]

A fortiori, where all the circumstances alleged to constitute the fraud were as well known to the complainant at the time of the transaction on which his rights are based as they are at the time when the petition is filed, a delay of eight years in applying for relief, the property having been in the meantime sold, will be an absolute bar to the enforcement of a claim.[3]

On the other hand the mere fact that the stockholders are aware that the directors are not faithfully defending a foreclosure suit will not conclude the corporation itself from seeking redress against a decree and sale procured by such fraud, if it acts promptly when freed from the control of the directors. That the stockholders have fruitlessly requested the directors to resign and employ other counsel, so far from throwing on the stockholders the peril of losing the rights in which they are represented by the company, if they do not personally assert them in place of the directors, operates of itself, without more, only to aggravate the wrong.[4]

A railroad company which has assented to a decree cannot, after waiting fifteen months or more, and agreeing to everything done, be allowed to come in, file an answer, and go back on their own express assent without bringing forward good reasons to account for this laches in failing to set up what it asserts to be good defences.[5]

A bill of review filed a few days before the sale is advertised to take place, and two years after the decree of foreclosure was entered, will, in the absence of some special circumstances justifying the delay, be dismissed on the ground of laches.[6]

The taking of an appeal from a decree of foreclosure and an order confirming the sale, on the ground that the court has no

1 Graham *v.* Boston, Hartford, & Erie R. Co. (1886), 118 U. S. 161.

2 Harwood *v.* Railroad Co. (1872), 17 Wall. 78.

3 Coddington *v.* Railroad Co. (1880), 103 U. S. 409.

4 Pacific R. Co. *v.* Missouri Pacific Ry. Co. (1884), 111 U. S. 505, overruling s. c. (1881), 6 Fed. Rep. 641.

5 Central Trust Co. *v.* Texas & St. L. Ry. Co (1885), 23 Fed. Rep. 846.

6 Farmers' Loan & Trust Co. *v.* Green Bay & M. R. Co. (1881), 6 Fed. Rep. 100.

jurisdiction, and that the sale was constructively fraudulent, in that the property was bought by the company's solicitor as trustee, suspends the control of every court except the appellate court, in respect to relief on the ground of actual fraud. The company, therefore, is not guilty of laches in seeking such relief when it files a bill for that purpose with reasonable promptitude after the dismissal of the appeal.[1]

§ 836. **Errors in or prior to Decree not reviewable on Motion to set aside Sale.** — Upon an application to set aside a judicial sale made pursuant to, and in full compliance with, a valid decree of a court directing it, objections to the sale based on errors in the decree, or committed by the court prior to its rendition, cannot be considered.[2]

§ 837. **Remedy by Annulment of Sale.** — If a contractor's lien extends only to a portion of the road, and the purchasers do not discharge the lien in money within a reasonable time fixed for that purpose, the proper remedy is not to annul the sale, even if the court has power to do it, but to order a resale of the entire property, or so much thereof as may be necessary to raise the amount due to the lienholders.[3]

[1] Pacific Railroad Co. of Missouri *v.* Missouri Pacific Ry. Co. (1884), 111 U. S. 505.

[2] Meyer *v.* Utah & Pleasant Valley Ry. Co. (1883), 3 Utah, 280.

[3] Farmers' Loan & Trust Co. *v.* Newman (1888), 127 U. S. 649. Here the court had authorized the receiver to purchase, for the benefit of those he represented, any adverse liens on the property. He made a contract with the owners of a lien paramount to that of the mortgage, whereby they were to receive for the same a sum of money secured by the proceeds of the portion of the road subject to their lien, and were, on their part, required to file a quit claim deed and certain trust-deed notes in escrow. This stipulation they fulfilled. Sale of the property as an entirety was made, and it was purchased for the bondholders, the price being paid in bonds, without the transfer of any cash. The Circuit Court decreed that these lienors were entitled to the amount contracted to be paid them, and that if it was not paid within a certain time the sale should be set aside, and the receiver resume possession. The Supreme Court held that, as the prior lien of these parties by the contract entitled them to the proceeds of the sale of this particular portion of the road, that agreement imposed upon the receiver and the bondholders the duty of obtaining from the court a modification of the decree of sale which would have enabled the court and the parties to know how much was realized from a sale of that part of the road upon which this prior lien rested, and that the sale of the mortgaged property as an entirety, without having obtained such modification, should, under the circumstances, be deemed an election upon the part of the trustees and those whom they represented, not to have the mortgaged property sold in parts or subject to this prior lien, and not to restrict this lien to that portion of the road embraced by the trust deed under which it was held. The lienors, therefore, had acquired a right to be paid first out of the aggregate proceeds of the sale of the entire line. This right was not to be defeated by the fact that the purchase-money was paid in bonds. If the purchasers failed to pay this claim, the property would have to be sold as an entirety, or a sufficiency of it to meet this prior lien, without annulling the former sale or con-

§ 838. **Declaring Purchaser a Trustee equivalent to Annulment.** — To declare the purchaser a trustee of the property bought is practically an annulment of the sale, so far as the applicant is concerned. The relief given against a fraudulent sale often takes this form, especially where the fraud complained of is that of the directors,[1] or of the directors and purchasers jointly.[2] So also, where a director purchases the property of the company without actual fraud, his fiduciary position renders the transaction a constructive fraud on the company, which may maintain a suit against him, or, after his death, against his representatives, to enforce a trust in its favor, and have the property reconveyed. The surrender is, of course, conditional upon the company's paying the director or his representatives the amount of his bid, and recouping him for his expenditures in operating the road; and the company will also be required to comply with the terms imposed by the court upon the director, as purchaser.[3]

But where a director is himself a bondholder, and becomes the purchaser upon foreclosure, an action cannot be maintained to impress a trust upon the property for the benefit of the stockholders, because of fraudulent conduct on the part of the directors in procuring the default, unless, at least, he is paid or tendered the amount of his bonds. The equity of the stockholders, if any, is only in the surplus after paying the bonded debt, and the action would be in effect a bill to redeem.[4]

Nor will the mere fact that the property is purchased by the president in his individual right raise a trust relation between him and a bondholder which will entitle the latter to treat him as a trustee for the property so purchased.[5]

§ 839. **Confirmation of Fraudulent Sale by Legislature.** — The confirmation of a fraudulent sale by the legislature is no bar to a suit by the stockholders to vacate it on the ground of fraud. To validate a fraudulent sale as against those prejudiced by it is beyond the power of any legislature.[6]

But such a ratification may work an estoppel as regards the

firmation, and without withdrawing or cancelling the deed, as that sale was subject to the power reserved to protect and enforce by subsequent orders any claim or lien then pending, either in court or by its leave, in a State court.

[1] Harpending *v.* Munson (1883), 91 N. Y. 650; s. c. 12 Am. & Eng. R. R. Cas. 408.

[2] Drury *v.* Cross (1868), 7 Wall. 299.

[3] Covington & Lexington R. Co. *v.* Bowler's Heirs (1872), 9 Bush (Ky.), 468.

[4] Harpending *v.* Munson (1883), 91 N. Y. 650; s. c. 12 Am. & Eng. R. R. Cas. 448.

[5] Credit Co. *v.* Arkansas Central R. Co. (1882), 15 Fed. Rep. 46.

[6] White Mountains R. Co. *v.* White Mountains (N. H.) R. Co. (1870), 50 N. H. 50; s. c. 1 Am. Ry. Rep. 146.

State itself. Thus where the State, after foreclosing its statutory lien upon a railroad, brings suit to rescind the sale, on the ground that there has been a fraudulent collusion between the purchasers and the commissioners appointed to hold the sale, and that the transferee of those purchasers acquired the property with knowledge of the fraud, the fact that the legislature confirms the title of the transferee constitutes a bar to the part of the petition which demands a reconveyance of the property to the State, but will not prevent the court from retaining jurisdiction of the cause for the purpose of compelling the commissioners and all who confederated with them to refund whatever profits they may have corruptly made out of the transaction.[1]

§ 840. **Effect of declaring a Sale void for Fraud.** — (a) *As to Corporation itself.* — The provisions of a statute declaring that a corporation shall be dissolved by a sale of its franchises have no application where the sale is a fraudulent and illegal one. The existence of the corporation still continues in spite of the sale, and a suit brought by it for a restoration of its property cannot be objected to by a new corporation which has purchased the franchises on the ground that such restoration will cause a dissolution of the defendant corporation.[2]

But the property will not be restored to the old corporation where it has actually consented to the sale, and the fraud alleged is that the purchasers induced it to withdraw its opposition to an application by the trustee for an order of sale, in consideration of their agreement to account for the property at its real value, and thereafter, by bribing the trustee, acquired such property at a price much lower than what it would have brought at an honestly conducted sale.[3]

(b) *As to Bondholders and other Creditors.* — When a foreclosure sale at which the property is bought in for the benefit of the bondholders is declared fraudulent and void as against certain judgment creditors, the mortgage is not thereby revived as to those bondholders who voluntarily take stock in a new company organized by them. The sale remains valid except so far as it prejudices the rights of the creditors who filed the bill to set it aside, and those bondholders, if any, who have not come

[1] State of Missouri *v.* McKay (1869), 43 Mo. 594.

[2] White Mountains R. Co. *v.* White Mountains (N. H.) R. Co. (1870), 50 N. H. 50; s. c. 1 Am. Ry. Rep. 146.

[3] White Mountains R. Co. *v.* White Mountains (N. H.) R. Co. (1870), 50 N. H. 50; s. c. 1 Am. Ry. Rep. 146. This case was decided on demurrer, and the appellate court did not determine what precise form the relief should take. See above.

into the reorganization scheme and converted their bonds into stock. Hence the reorganizing bondholders cannot maintain a bill for the foreclosure of the mortgage on the theory that it is still in force as to them.[1]

By satisfying the judgment creditors they can keep the property, and their title is good against all the world. The legal effect of the decree avoiding the sale is that, by reason of the frauds perpetrated in such sale, the property is subject to the claims of the creditors. Hence they cannot maintain an action to recover back the purchase-money, for, when they paid it into court, they were, in fact, paying off an incumbrance on their own property.[2]

Nor can they be subrogated to, and obtain the benefit of, the decree of foreclosure, upon which the money was paid.[3]

Nor can they recover back the purchase-money on the ground that it was paid under a mistake of fact. The mistake, if any, in such a case is a mistake of law.[4]

If a judgment creditor whose lien is subsequent to that of a trust deed becomes the purchaser of the property at the foreclosure sale, and enters satisfaction of his judgments, solely for the purpose of clearing the title, and without receiving any consideration therefor, and the sale is afterwards set aside for causes not implicating him, he may maintain a bill to annul the cancellation of his judgments, and re-establish their lien.[5]

ARTICLE III.—GROUNDS FOR VACATING A SALE.

§ 841. **Inadequacy of Price.** — To induce a court to set aside a foreclosure sale on the mere ground of the inadequacy of the price, it is not sufficient to show that the property has not realized its full value.[6]

The price must be so inadequate as to show that it is not the result of fair dealing and an honest purchase.[7]

Or, as it is sometimes put, the inadequacy must be such as

[1] Barnes *v.* Chicago, M. & St. Paul R. Co. (1879), 8 Biss. 514.

[2] Railroad Co. *v.* Soutter (1871), 13 Wall. 517; followed in Barnes *v.* Chicago, M. & St. Paul Ry. Co. (1887), 122 U. S. 1; s. c. 7 Sup. Ct. Rep. 1043.

[3] Railroad Co. *v.* Soutter (1871), 13 Wall. 517.

[4] Railroad Co. *v.* Soutter (1871), 13 Wall. 517, 526 (Field, J., dissenting).

[5] Hay *v.* Washington & Alexandria R. Co. (1881), 4 Hughes, 327. See note to this case, 1 Am. & Eng. R. R. Cas. 517.

[6] Sahlgaard *v.* Kennedy (1882), 13 Fed. Rep. 242, 248.

[7] Turner *v.* Indianapolis, B. & W. Ry. Co. (1878), 8 Biss. 350.

will shock the conscience, and amount in itself to conclusive and decisive evidence of fraud.[1]

Or the inadequacy of price must be combined with additional circumstances against the fairness of the sale, growing out of fraud, accident, or some trust relation of the parties.[2]

No sale will be set aside for inadequacy of price, when the sum obtained exceeds the "upset price" fixed by the court.[3]

A sale of personal property under a decree of foreclosure may be set aside for an advance of price, before the same is confirmed.[4]

§ 842. **Actual Fraud.** — Suspicious circumstances calling for explanations are not to be viewed in the light of after events for a correct interpretation. All the facts and circumstances must be considered as they existed with respect to the property involved at the time action was had with regard thereto.[5]

[1] Peck *v.* New Jersey & New York R. Co. (1880), 22 Hun, 129; Fidelity Trust Co. *v.* Mobile Street Ry. Co. (1893), 54 Fed. Rep. 26.

[2] Fidelity Trust Co. *v.* Mobile Street Ry. Co. (1893), 54 Fed. Rep. 26, where it was held that the fact that the bondholders were known to have authorized a committee to bid up to $400,000, and that this deterred others from bidding, was not a sufficient ground for setting aside the sale.

[3] Kropholler *v.* St. Paul & Pacific Ry. Co. (1880), 2 Fed. Rep. 302; Wetmore *v.* St. Paul & Pacific R. Co. (1880), 5 Dill. 531; s. c. 3 Fed. Rep. 177. The court said in the latter case: "Of course the court, in fixing an 'upset price,' intended to say that it was better that it should sell at that price than not to sell at all, and the court had taken the necessary means to get all the information on the subject possible as the case stood at that time. It is wrong to suppose that the same court will now set aside the sale, which brings a million and a half dollars, because of the objection that now, in the light of a year or two after that, in the improved circumstances and the prosperous times, in the value attaching to that road, growing out of the connections newly made, we are now to consider the thing as of the present time in relation to its value at the time the sale was made. This is one of those constant every-day events of people who have let things slip out of their hands, coming back afterwards to endeavor to secure the value which they failed to recognize or secure at the time."

An elaborate review of the proper practice when an advance bid is tendered after the sale and before its confirmation will be found in the opinion of Judge Hammond in Blackburn *v.* Selma R. Co. (1880), 3 Fed. Rep. 689.

See also Turner *v.* Indianapolis, B. & W. Ry. Co. (1878), 8 Biss. 380, where it was said that, if parties desire to have the sale of railroad property set aside for the inadequacy of the bid, they must show that some person who is responsible will make an advance bid. In Allen *v.* Montgomery & West Point R. Co. (1847), 11 Ala. 437, it was said by the court to be very questionable whether a judgment creditor could, upon the allegation that the sale had been made for an inadequate price, have the biddings opened, unless he offered to bid a larger sum. But the point was not directly ruled upon.

[4] Blackburn *v.* Selma R. Co. (1880), 3 Fed. Rep. 689.

[5] Sahlgaard *v.* Kennedy (1882), 13 Fed. Rep. 248. In this case the court declined to rule that the circumstances showed fraud, thus summarizing the position of affairs at the time of the foreclosure: "The foreclosure suits had been long pending. All parties concerned knew

§ 843. **Collusion between Trustees and Purchasers.** — The participation of the trustee in a scheme by which a purchasing syndicate acquires the property in such a manner as to defraud the rest of the bondholders of their rights is an actual, not a constructive, fraud.[1]

A bill filed by a bondholder to set aside a sale is therefore not demurrable when it contains allegations tending to show that one of the trustees under the mortgage combined with the purchasing bondholders at the sale to bid in the property at a sacrifice of the interests of the rest of the bondholders, of whom the complainant is one, and that the trustee permitted the property to pass into the hands of such purchasers.[2]

Nor is a bill filed by the mortgagor company for a like purpose demurrable which alleges that such mortgagor, in consideration of an agreement by the combination of bondholders who were to purchase the property that their debts would be credited to the full value of the property, whatever the price actually realized at the sale might be, withdrew its opposition to a sale by the trustee; that the sale was made to this combination of bondholders, who, by bribing the trustee, obtained the property at a low price; and that the mortgagor's debts were credited only with the price which the purchasers had bid at the sale. If the mortgagor, upon ascertaining, several years afterwards, the fact of the bribery, and the failure of the purchasers to comply with their agreement to account for the property at its real value, applies for relief against the title thus fraudulently obtained to its property, it is entitled to relief in some form. The property will not be restored to it, since it consented to the order to sell; but whether the auction sale should be annulled, and a resale ordered, or the purchasers compelled to account for the property at a fair price, or in what precise form the relief should be granted, was not deter-

that, without relief from some unknown quarter, decrees and sales would eventually follow. The bondholders, represented by their trustees, were urging such decrees and sales. In the meantime the depreciated bonds were on the market, subject to the outcome of pending litigation. The majority resolved on the course deemed best for the interests of all, and urged all to join them. The known end was reached, ample opportunity for rescue having been given to the minority bondholders to appear, if they chose to incur the needed responsibility for averting the catastrophe. They did not choose to move in the matter, although invited so to do. Where, then, is the actual fraud? None appears. Mere inadequacy of consideration at a judicial sale does not establish a fraud."

[1] Sahlgaard *v.* Kennedy (1882), 13 Fed. Rep. 242, 249.

[2] Sahlgaard *v.* Kennedy (1880), 2 Fed. Rep. 295.

mined by the court in overruling the demurrer to the bill in question.[1]

§ 844. **Collusion between Trustee and Corporate Officers.** — A trustee sold a railroad, under the power conferred by the mortgage, acting as auctioneer himself. In the notice of sale it was stated that the mortgage amounted to $2,000,000, and that the interest in default was $70,000. The trustee purchased it for the directors, and organized a new company, which went into possession of the property. The notice of sale was a gross misstatement of the real position of the company's estate. As a matter of fact, less than $200,000 of the bonds had passed into the hands of *bona fide* purchasers, and a large number had been cancelled. Besides this, a considerable amount had been placed by the directors to secure small loans, their object being to purchase the pledged bonds at a low price. This they did, buying them for five cents on the dollar; and by this device they obtained control of the great bulk of the bonds for what was practically no consideration. The notice of sale was therefore such a misrepresentation regarding the amount due as would preclude the possibility of any fair bidding, and indeed to exclude from the purchase every one except those engaged in the perpetration of the fraud. Upon this state of facts it was held by the Supreme Court of the United States, reversing the judgment of the Circuit Court, that the decree should be set aside, and the new railroad company perpetually enjoined from setting up any right or title under it, the mortgage to remain as security for the bonds held by *bona fide* purchasers.[2]

§ 845. **Collusion between Corporate Officers and Combinations of Bondholders.** — Where a minority of bondholders contrive with officers of the company in a fraudulent manner to sell the property at an immense sacrifice and to buy it in themselves, such sale will be set aside at the instance of the rest of the bondholders and the lien of the mortgage declared still to exist, and a resale will be ordered in the same suit for the benefit of all concerned. In another case the directors of a railroad company had become liable as indorsers for $21,000, on a contract for iron rails furnished for the road, and had given, as collateral, $42,000 of an issue of bonds to the vendor. Similar bonds to the amount of $280,000, which had never been issued, were placed in the hands of a firm, not to be issued until the

[1] White Mountains R. Co. *v.* White Mountains (N. H.) R. Co. (1870), 50 N. H. 50; s. c. 1 Am. Ry. Rep. 146.

[2] James *v.* Railroad Co. (1867), 6 Wall. 752.

first-named debt had been paid and twenty-seven miles of roadway constructed. When pressed as indorsers to pay this debt, they conceived a plan to have this debt bought in by other parties at a large discount, and to have a foreclosure of the mortgage on the few miles of road, franchises, outfits, etc., that these parties might buy it in. It was foreseen that, if the property should be sold for this small amount of bonds, there could probably be an active competition in the bids, and in order to deter bidders it was arranged to have the $280,000 of bonds on deposit which could never be issued legally, as the matter stood, forced *pro forma* upon the first-named creditor, though he did not ask it as additional collateral, and have a sale of them as pledged bonds, with the understanding that the other party to the fraudulent arrangement should bid them in at a nominal sum. They then allowed the sale for the whole amount of the bonds, and their confederates purchased the property for less than its value. The vendors of certain locomotives which had been sold under this foreclosure obtained judgment for the amount due them against the company, and filed their bill to set aside the decree and sale as fraudulent. The Circuit Court dismissed the bill, but on appeal the Supreme Court remanded the cause with directions to the court below to hold these purchasers as trustees to the complainant creditors for the full value of the property, from which they were to be allowed to retain the amount due at the day of sale on the judgment against the directors.[1]

That the directors were actuated by corrupt motives in suffering a default is no ground for setting aside the sale, even if the trustee is aware of the existence of such motives, unless it is also shown that there was also some collusion between them and him.[2]

An agreement between creditors to combine and purchase the property will not of itself render the sale fraudulent.[3]

[1] Drury *v.* Cross (1868), 7 Wall. 299.

[2] Harpending *v.* Munson (1883), 91 N. Y. 650; s. c. 12 Am. & Eng. R. R. Cas. 408.

[3] Kropholler *v.* St. Paul & Pacific R. Co. (1880), 2 Fed. Rep. 302; Wetmore *v.* St. Paul & Pacific R. Co. (1880), 5 Dill. 531. In the latter case the court said: "Because the men co-operated and put themselves into condition to buy the road, it does not seem that they were therefore acting in any fraudulent manner. They deprived none of the petitioners of their rights. They were at liberty to join the 'syndicate,' as it was called; they were at liberty to bid; they were at liberty to come in and make themselves parties. They did nothing of the kind. Were the bondholders who purchased the road to be put into the condition of a single man who owned twelve millions out of fifteen millions of bonds? I can see no reason why they should not take steps to have the road sold, and buy it as cheap as they could get it, provided they cheated or hindered nobody in the matter." See also chapter on reorganization.

§ 846. **Surprise, Mistake, etc.** — A case for relief on the ground of surprise is made out by a showing that the petitioner did not know that a larger amount than that mentioned in the complaint in the foreclosure suit had been found due until two days before the sale; that he thereupon took *ex parte* proceedings to set aside the judgment and stay the sale; and that the order staying the sale was set aside as irregular on the day of the sale, too late to enable him to take other proceedings or to attend the sale to protect his rights.[1]

§ 847. **Breach of Professional Duty by Attorney.** — An attorney is not guilty of such a breach of professional duty as will require the sale to be vacated, when, after appearing for a railroad company to contest a motion made by a single petitioning creditor for the appointment of a receiver, he acts as counsel for the trustees of the bondholders in foreclosure proceedings against the same company. There is no such conflict of duties caused by assuming these positions successively as to make the two appearances an anomaly in chancery practice so great as to vitiate the decree.[2]

§ 848. **Sale not set aside because same Person is Trustee under both Mortgages foreclosed.** — The fact that the same person was the trustee both of a first and a second mortgage foreclosed in the same suit is no ground for invalidating the sale at the instance of second-mortgage bondholders where no evidence of collusion is offered, and the complainant bondholders had full knowledge of the situation of affairs, and full opportunity to intervene as parties to the suit.[3]

§ 849. **Extension of Benefits of Reorganization to Bondholders after Time for coming in has passed not Ground for invalidating Sale.** — The extension of the benefits of a reorganization agreement to bondholders after the time for coming in has passed is not a ground upon which one of the bondholders who joined the combination of purchasers before that time can have the sale annulled. Agreements of this kind are apt to operate to the disadvantage of the poorer and more helpless bondholders, and the extension of their privilege to all the bondholders, regardless of the time at which they express their adhesion to the scheme, will be regarded by a court of equity with complacency, at least, — cer-

[1] Peck *v.* New York & New Jersey Ry. Co. (1881), 85 N. Y. 246; s. c. 7 Am. & Eng. R. R. Cas. 422. But the court, upon review of all the facts, held that it was within the discretion of the trial court to say whether the petitioner should or should not be relieved.

[2] Shaw *v.* Bill (1876), 95 U. S. 10.

[3] Robinson *v.* Iron Ry. Co. (1889), 135 U. S. 522; s. c. 10 Sup. Ct. Rep. 907.

tainly not with disfavor. An application to exclude from participation in the benefits of such agreement, solely on the ground that they have come in after the time limited, lacks the essential elements of equity.[1]

§ 850. **Foreclosure before Maturity of Principal.** — A sale not tainted with fraud, and consummated by the consent of the creditors and the company, in pursuance of a plan of reorganization, will not be set aside at the suit of some of the stockholders, merely because the principal of one of the mortgages was not yet due, when it appears that the sums due for interest thereon, for floating indebtedness, and on other mortgages then due, was so great as to render foreclosure inevitable, especially when the complainants do not offer to do equity by paying the floating debt, and have not been diligent in opposing the plan of reorganization and in attaching the decree objected to.[2]

§ 851. **Excessive Amount of Judgments.** — The provision of the New York Code (§ 1207), providing that, "where there is no answer, the judgment shall not be more favorable to the plaintiff than that demanded in the complaint," is intended for the benefit of defendants who suffer default, and cannot be invoked in an attack upon a judgment by one not a defendant or interested in the defence of the action. Hence when the complaint in a foreclosure suit states the amount of outstanding bonds at a less figure than that found by the referee who was ordered to find the amount due, this provision is not available to a bondholder moving to set aside the judgment entered on the report and the sale thereunder.[3]

[1] Walker *v.* Montclair & Greenwood Lake Ry. Co. (1879), 30 N. J. Eq. 525.

[2] Cary *v.* Houston & T. C. Ry. Co. (1892), 52 Fed. Rep. 671.

[3] Peck *v.* New York & New Jersey Ry. Co. (1881), 85 N. Y. 246; s. c. 7 Am. & Eng. R. R. Cas. 422.

CHAPTER XXXVIII.

APPEALS FROM DECREES AND ORDERS IN FORECLOSURE SUITS.

ARTICLE I. — JURISDICTION AND PARTIES TO APPEALS.

§ 852. **Jurisdiction in general.** — For purposes of appeal to United States Supreme Court, it is not necessary to inquire when Circuit Court first obtained jurisdiction of suit. It is sufficient if it had jurisdiction when decree appealed from was rendered.[1]

The appellate jurisdiction of courts is ordinarily, of course, fixed without reference to any particular case; but it has been held that the legislature has power to confer upon a court of appeals already in existence the right to hear appeals in special

[1] Pacific Railroad *v.* Ketchum (1879), 101 U. S. 289.

cases. Such a law, however, is not constitutional, unless it leaves the judicial functions untrammelled. The mere enumeration therein of the questions referred to the court — those questions being all necessarily involved in the decision appealed from — neither enlarges nor restricts the powers of the court, nor invests it with original jurisdiction.[1]

§ 853. **Jurisdiction of Supreme Court of United States as dependent on Amount involved.** — The matter in dispute on which the jurisdiction of the Supreme Court of the United States depends is "the matter which is directly in dispute in the particular cause in which the judgment or decree sought to be reviewed is rendered," and it is not allowable, for the purpose of determining its value, to estimate its collateral effect in a subsequent suit between the same or other parties. Thus a decree in a foreclosure suit brought by some of the bondholders to enforce the payment of interest amounting in the aggregate to less than $5,000 is not appealable, the only matter directly involved being the right of the complainants to have the mortgaged property sold to pay the several amounts due to them respectively on their bonds.[2]

Where parties severally assert in the same suit a separate course of action, the decrees which are rendered in favor of the complainants cannot be joined to render the amount sufficient to give the Supreme Court jurisdiction.[3] If some of the decrees in such a case are for more than $5,000, and some for less, the appeal will be retained as to the former, and dismissed as to the latter.[4]

If a bondholder sues in the first place for interest amounting to more than $5,000, and after amending his complaint by permission of court obtains judgment for less than $5,000, the result as regards the jurisdiction of the Supreme Court is the same as though he had originally brought suit for an amount below jurisdictional limit.[5]

[1] State of Maryland *v.* Northern Central Ry. Co. (1861), 18 Md. 193.

Upon a question of priority of judgment liens, an objection to the jurisdiction of the court to appoint receivers for a corporation, to include other property than that upon which the complaining creditors claim a lien is waived, unless taken *in limine*. Temple *v.* Glasgow (1897), 80 Fed. Rep. 441.

[2] Bruce *v.* Manchester & Keene Railroad (1885), 117 U. S. 514.

[3] Farmers' Loan & Trust Co. *v.* Waterman (1882), 106 U. S. 265.

[4] Hassell, Trustee, *v.* Wilcox (1885), 115 U. S. 598.

[5] Opelika City *v.* Daniel (1883), 109 U. S. 108.

An appeal to the Court of Appeals of Kentucky may be taken from a judgment placing a railroad in the hands of a receiver, without regard to the amount in controversy. Nashville, C. & St. L. Ry. Co. *v.* Mattingly (1897), 40 S. W. Rep. 673.

§ 854. **Supersedeas Bonds.** — A *supersedeas* bond should not be exacted by a federal court from a receiver who appeals in good faith from judgment against him in action brought in State court under authority of United States law permitting him to be sued in that court.[1]

Appeal from a decree in favor of an appellant suspends execution of decree. A *supersedeas* bond to suspend a decree is required only in cases from an adverse decree. Where the defendant files a cross-appeal, he need not file a *supersedeas* bond if there has also been an appeal by complainant, for the appeal of the latter from the decree in his favor has already effected a stay of its execution.[2]

A *supersedeas* in connection with an appeal is a statutory remedy. To obtain it, the required conditions must be strictly complied with. Time is an essential element in the proceedings, which can be disregarded by neither court nor judges. There was held to be no *supersedeas* as to the decree in case cited below, as the application and bond for it were filed more than sixty days after the decree, the parties filing it having been guilty of the delay themselves. A court cannot enter a *nunc pro tunc* order to cure the defect, unless the delay has been caused by the court itself for its convenience.[3]

§ 855. **Who may appeal in general.** — Any one who is adversely affected by a decree may, where the matter in dispute involves a sufficient amount, appeal.[4]

A bondholder coming into a reorganization scheme which includes the issue of a new mortgage after the sale, and an application of part of the proceeds of such mortgage to the payment of expenses of trustees, has a right to intervene and be heard in regard to the amount of the compensation to be allowed, and to appeal from an adverse decision. Where a purchasing committee of bondholders has been formed to carry out the reorganization scheme, the right of appeal may be exercised by that body in behalf of all the bondholders.[5]

This privilege of appeal may sometimes be asserted by bondholders who are allowed to intervene as defendants in a foreclosure suit, subsequently to the bill's being taken *pro confesso* and a decree entered accordingly, and, as defendant interveners,

[1] Central Trust Co. *v.* St. Louis, A. & T. Ry. Co. (1870), 41 Fed. Rep. 551.

[2] Bronson *v.* La Crosse & Milwaukee R. Co. *et al.* (1863), 1 Wall. 405.

[3] Sage *et al. v.* Central Railroad Co. of Iowa *et al.* (1876), 93 U. S. 417.

[4] *Ex parte* Railroad Company (1877), 95 U. S. 221.

[5] Williams *v.* Morgan (1883), 111 U. S. 684.

take exceptions to the report of a master in regard to the confirmation of that decree. In such a case leave to appeal from injurious parts of decree cannot be refused on ground that bill has been taken *pro confesso*, when decree entered thereupon does not end the case, the final decree being only rendered after a number of orders, references, and reports have been made, and at a time when the petitioners for leave to appeal have become actual parties.[1] The right of the bondholders to prosecute an appeal from a foreclosure decree through the trustees is not affected by the fact that, after the rendition of that decree, certain lien creditors, who are joined as parties defendant, file a cross-bill, seeking to invalidate a prior lien set up by another defendant. Such a proceeding cannot in any wise abridge the right of trustees to enforce the mortgage, and has no bearing upon questions presented for consideration by the bill asking for foreclosure.[2]

Where a decree, for instance, on a petition in intervention by the holder of a judgment for personal injuries against a railroad company, under § 1528, Gen. St. S. C. 1882, in a foreclosure suit, claiming priority of lien to the mortgage, adjudicates priority to the judgment, finds the amount due, and decrees that the priority must be secured in any order of sale of the railroad thereafter made, an appeal will lie from that decree, though the main suit may not have reached a final decree.[3]

§ 856. **Who cannot appeal in general.** — One who is neither an original party to the suit nor an intervener, whether in his individual capacity or by representation, cannot appeal.[4]

Under this rule no appeal can be taken by one whose petition to be allowed to intervene to protect an alleged interest in the bonds which are the subject of the suit is denied.[5]

The principle that no one but an actual party to the suit can appeal, involves the corollary that the administrator of one who was not a party cannot acquire the right to prosecute an appeal already in progress simply by filing letters testamentary. He must first be admitted as a party in the lower court.[6]

[1] *Ex parte* Jordan (1876), 94 U. S. 248.

[2] Bronson *v.* La Crosse R. Co. (1863), 2 Black, 528.

[3] Central Trust Co. of New York *v.* Madden (1895), 70 Fed. Rep. 451; s. c. 17 C. C. A. 31.

[4] *Ex parte* Cutting (1876), 94 U. S. 14; *Ex parte* Cockcroft (1881), 104 U. S. 578; Guion *v.* Liverpool, London, & Globe Ins. Co. (1883), 109 U. S. 173; Farmers' Loan & Trust Co. *v.* Waterman (1882), 106 U. S. 269.

[5] Indiana Southern R. Co. *v.* Liverpool, London, & Globe Ins. Co. (1883), 109 U. S. 168.

[6] State *v.* Florida Central R. Co. (1876), 15 Fla. 690.

Nor can an appeal be taken from a decree by one who, though a party, is in no way affected by what is decreed. Thus a trustee who has sold the mortgaged property pursuant to a decree, providing that the purchasers shall pay such back claims as may finally be adjudged proper, has no interest in the controversy afterwards conducted between the holders of those claims and the purchasers, and cannot be a party to an appeal from the decree determining that controversy.[1]

Nor can one who is a party merely in a representative capacity appeal, unless he appeals for the whole body of those whom he represents. A petition by a trustee to be allowed to take an appeal for a small minority of the bondholders, against the interests of a large majority who had agreed upon the decree, may be properly denied.[2]

The representative character of the trustee need not be stated expressly in the order to the clerk to enter the appeal. In a case in which this objection was raised the court said: "[The trustee] in his character as trustee, was a party to the proceedings, and it was against him in that character that the decree appealed for was made. It would be hypercritical to construe the order to the clerk to enter the appeal as having been intended to assert the right of appeal in any other character or relation than that in which he was party to the case, and, as such, entitled to take the appeal.

"The order should be fairly construed with reference to the relation of the appellant to the proceeding, and the nature of the decree against him. Construing the order thus, he is here on the appeal, as trustee, *representing the first-mortgage bondholders.*"[3] The only party who can assign as error the refusal of the court to dismiss a bill for failure to reply to a plea to the jurisdiction is the party who submits the plea. Hence, when one defendant pleads to the jurisdiction and another answers setting up an independent controversy, and a final decree is entered sustaining the rights set up in the answer, no notice having been taken, while the suit was in progress, of the plea to the jurisdiction, the complainant cannot have his bill dismissed for failure to reply to that plea, especially after an appeal

1 Farmers' Loan & Trust Co. *v.* Waterman (1882), 106 U. S. 269.

2 Sage *v.* Central R. Co. of Iowa (1876), 93 U. S. 417. In this case these minority bondholders were allowed afterwards to be made parties to the proceedings, with a view to appealing in their own names from the decree, and such an appeal was considered properly taken.

3 Tome *v.* King (1885), 64 Md. 166; s. c. 21 Atl. Rep. 279.

has been taken and the defendant who submitted the plea is not a party thereto.[1]

§ 857. **Purchaser at Foreclosure Sale as Appellant.** — A purchaser at a foreclosure sale, although not a party to the suit, will in some cases be allowed to appeal from decree, upon principle that, as he subjects himself by his purchase to the jurisdiction of the court, in so far as the purchase itself is concerned, and can be compelled to perform his agreement specifically, he acquires a right to appear and claim such relief as he is entitled to by the rules of equity procedure.[2]

§ 858. **Appeal from Decrees against Receivers.** — A receiver cannot, as a general rule, question a decree rendered for or against him by the court which appointed him, but a person aggrieved by such a decree may appeal, in a proper case, to a higher court.[3]

An appeal by the receiver himself is allowable whenever he occupies the position of a real party in interest with regard to the subject-matter of the decree. He may appeal from a decree rendered after the sale of the premises, directing him to pay into court a certain sum of money, the balance found to be due from him on the settlement of his accounts.[4]

If a person is not only receiver, but also a bondholder, and in the latter capacity will be obliged, as the result of the decree fixing the amount of the commissions of the several receivers and trustees, to pay his co-receivers and the trustees a large

[1] Chicago & Alton R. Co. *v.* Union Rolling Mill Co. (1884), 109 U. S. 702.

[2] Blossom *v.* The Milwaukee, etc. Railroad Co. (1863), 1 Wall. 655. In the course of the argument leading up to the principle enunciated in the text, the court used the following language: "He cannot appeal from the original decree of foreclosure, nor from any other order or decree of the court made prior to his bid. It, however, seems to be well settled that after a decree adjudicating certain rights between the parties to a suit, other persons having no previous interest in the litigation may become connected with the case in the course of the subsequent proceedings in such a manner as to subject them to the jurisdiction of the court and render them liable to its order; and that they may in like manner acquire rights in regard to the subject-matter of the litigation, which the court is bound to protect. Sureties signing appeal bonds, stay bonds, delivery bonds, and receipts under writ of attachment, become *quasi* parties to the proceedings, and subject themselves to the jurisdiction of the court, so that summary judgments may be rendered on their bonds or recognizances. So in case of a creditor's bill or other suit by which a fund is to be distributed to parties, some of which are not before the court; these are at liberty to come before the master after the decrees, and establish their claims to share in the distributions." To the same effect is Central Trust Co. *v.* Grant Locomotive Works (1890), 135 U. S. 207; s. c. 43 Am. & Eng. R. R. Cas. 504.

[3] Melandy *v.* Barbour (1884), 78 Va. 544; s. c. 25 Am. & Eng. R. R. Cas. 622.

[4] Hinckley *v.* Gilman, Clinton, & Springfield R. Co. (1876), 94 U. S. 467.

sum above what he is entitled to as a receiver, he is entitled to appeal.[1]

§ 859. **Junior Incumbrancers as Appellants.** — A junior incumbrancer cannot contest the propriety of a judgment against the foreclosing mortgagor who did not appeal, without showing that he was or might be aggrieved by it, if allowed to stand. But where it appears from the complaint that the mortgagor is an insolvent corporation, that executions against it are being returned unsatisfied, that proceedings by sequestration and creditors' bills have been instituted against it, and that the creditors are struggling against each other to save themselves, the court will assume that a junior incumbrancer has sufficient interest in the amount of the judgment against the mortgagor to enable him to contest it.[2]

§ 860. **Stockholders as Appellants.** — As a corporation is an artificial being representing the whole body of stockholders, no individual stockholder can prosecute an appeal from a judgment against the corporation.[3] On the other hand, it has been suggested by a court which denied a stockholder permission to become a party defendant, and make answer and defence after the rendition of the final decree in a foreclosure suit, that he might possibly be made a party for the purpose of appealing.[4]

§ 861. **Company as Party to Appeal.** — Where the proceeds of the sale are less than one-half the indebtedness, the company is not a necessary party to an appeal taken, after the confirmation of the sale, from a decree declaring certain receiver's certificates to be a lien on such proceeds, unless, perhaps, where the law makes the stockholders individually liable for a deficiency in the proceeds.[5]

§ 862. **Trustee as Party to Appeal.** — If a decree is entered in a State court against a railroad company and the trustees, and an appeal is thereupon taken to the appellate court of the State by the company alone, the trustees having no interest in the

[1] Tome *v.* King (1885), 64 Md. 166; s. c. 21 Atl. Rep. 279.

[2] Jesup *v.* City of Racine (1861), 14 Wis. 331.

An adjudication as to the rights of subsequent lienors will not be reviewed on appeal where the proceeds of a foreclosure sale were not more than sufficient to satisfy two superior liens. Illinois Trust & Savings Bank *v.* Pacific Ry. Co. (1896), 47 Pac. Rep. 60.

[3] State *v.* Florida Central R. Co. (1876), 15 Fla. 690, 725.

[4] *Ex parte* Brown (1877), 58 Ala. 536; s. c. 21 Am. Ry. Rep. 101.

[5] Mercantile Trust Co. *v.* Kanawha & C. Ry. Co. (1893), 58 Fed. Rep. 6; s. c. 7 C. C. A. 3.

result, the company, upon affirmation of the decree, can bring a writ of error to the Supreme Court of the United States without joining the trustees as parties.[1]

Article II. — Appealable Decrees and Orders.

§ 863. **Consent Decrees.** — A consent decree cannot, as a general rule, be appealed from.[2] But section 692 of the Revised Statutes, providing that an appeal shall be allowed from all final decrees in the Circuit Courts, when the matter in dispute exceeds $5,000, and that the Supreme Court "shall receive, hear, and determine such appeals," has been held to make appeals, within the prescribed limits, a matter of right. The Supreme Court will not consider any errors assigned which were in law waived by the consent, but it must still receive and decide the case. If all the errors complained of come within the waiver, the decree below will be affirmed, but only after hearing.[3]

§ 864. **Discretionary Orders not reviewable.**[4] — The action of a lower court in denying relief from the sale, asked for by bondholder on ground of mistake and surprise, is not subject to reversal on appeal, where it appears that the sale was duly advertised; that petitioner obtained no stay; that he offered no proof of value of bonds, or even that he owned them; that the property may, so far as the evidence goes, have been sold at an adequate price; that petitioner did not offer any definite sum which he would pay upon resale, or show that he was able to bid off the property; and, finally, that he was allowed to come into a reorganization on same footing as other bondholders.[5]

Nor does an appeal lie from order of lower court denying motion, in pending suit, to permit a person to intervene and become a party;[6] nor from an order granting a stay of sale, if, in view of facts before court, the order directing the sale was an exercise of discretionary powers. Having the power, in the exercise of its discretion, to vacate the order of sale absolutely, or to modify it, the court can attach any conditions it sees fit

[1] Norwich & Worcester R. Co. *v.* Johnson (1872), 15 Wall. 8.

[2] State of Tennessee *v.* McMinnville & Manchester R. Co. (1880), 6 Lea (Tenn.), 369; s. c. 4 Am. & Eng. R. R. Cas. 95; Hayne on New Trial and Appeal, § 282.

[3] Pacific Railroad *v.* Ketchum (1879), 101 U. S. 289.

[4] Central Trust Co. *v.* Grant Locomotive Works (1889), 135 U. S. 207; s. c. 43 Am. & Eng. R. R. Cas. 503.

[5] Peck *v.* New York & New Jersey Ry. Co. (1881), 85 N. Y. 246.

[6] *Ex parte* Cutting (1876), 94 U. S. 14.

to the affirmance of the order, and can therefore grant a stay, and give leave to review any application to vacate the order which may previously have been rejected.[1]

The refusal of the lower court to grant leave to file a cross-bill constitutes no ground of appeal, when it is discretionary.[2]

No appeal lies from order amending pleadings in an equity proceeding.[3]

An order authorizing the issue of receiver's certificates is in one sense a matter within the discretion of the court, but not in such a sense as to prevent an appeal from the order. As such action necessarily raises the question whether the court has invaded established rights of the lien creditors, contrary to law, the latter are entitled to take an appeal on the point whether the discretionary power, if it is such, has been exercised in a manner which cannot be reviewed in the appellate court.[4]

§ 865. **Final Decree in general.** — A decree is final for the purposes of appeal, when it terminates the litigation between the parties on the merits, and leaves nothing to be done but to enforce by execution what has been determined.[5]

§ 866. **Decree dismissing Cross-bill not Final.** — The original bill and cross-bill constitute one suit. A decree dismissing a cross-bill disposes of a proceeding simply incidental to the principal matter in litigation, and is therefore interlocutory, and not reviewable except upon appeal from final decree.[6]

§ 867. **Foreclosure Decree.** — A decree of foreclosure in the ordinary form, declaring nature and extent of default, the breach of condition which justifies foreclosure, and amount due on account of the breach, and ordering a sale of the property in the event of money not being paid at a certain date, is the final decree which determines and fixes the rights of the parties, and from which an appeal lies.[7]

[1] Syracuse Savings Bank *v.* Syracuse R. Co. (1882), 88 N. Y. 110; s. c. 9 Am. & Eng. R. R. Cas. 585.

[2] Southern Indiana R. Co. v. Liverpool, London, & Globe Ins. Co. (1883), 109 U. S. 168.

[3] State *v.* Brown (1885), 64 Md. 199; s. c. 1 Atl. Rep. 54; 6 Atl. Rep. 172; 24 Am. & Eng. R. R. Cas. 192.

[4] Farmers' Loan & Trust Co., Petitioner (1888), 129 U. S. 206; s. c. 9 Sup. Ct. Rep. 265.

[5] St. Louis, Iron Mountain, & Southern R. Co. *v.* Southern Express Co. (1882), 108 U. S. 24; s. c. 2 Sup. Ct. Rep. 6; Elliot's Appellate Proc., § 90. See also Central Trust Co. *v.* Grant Locomotive Works (1889), 135 U. S. 207; s. c. 43 Am. & Eng. R. R. Cas. 503.

A decree, as a rule, is not regarded as absolutely final until the end of the term; but its finality becomes fixed before that time, if the party against whom it is rendered makes a motion to rescind it, and the motion is denied. Railroad Co. *v.* Bradleys (1868), 7 Wall. 575.

[6] *Ex parte* Railroad Co. (1877), 95 U. S. 225.

[7] Chicago, D. & Vincennes R. Co. *v.* Fosdick (1882), 106 U. S. 47, 70.

The merits of the controversy are then finally settled, and subsequent proceedings are simply a means of executing the decree.[1]

For like reasons, an order made in obedience to mandate from the Supreme Court, ascertaining amount of interest due on the mortgage bonds, directing payment within one year, and providing for an order of sale in default of payment, is a *final decree*, to the extent that any person aggrieved by supposed error in finding the amount of interest, or in court having omitted to carry out the entire mandate of the Supreme Court, may appeal from it.[2]

A decree of sale of mortgaged premises is a final decree.[3]

It is essential to the appealability of a foreclosure decree that it should determine the amount of the debt which must be paid in order to stop the sale, and the amount of the mortgaged property which is to be sold, if that amount is not paid.[4] But it is none the less final because the priorities of conflicting liens and the amount of bonds to be paid off are left to be settled by subsequent decrees,[5] or because, at the time of the decree, there are still left undetermined some exceptions to a master's report, not relating to the trustee's claim, but collateral to the suit, and concerning the defendants alone.[6]

A decree dissolving a temporary injunction restraining a foreclosure sale, and directing the sale to proceed, simply relegates the rights of the parties to the position in which they were before the injunction, and is necessarily, therefore, a final decree.[7]

So also a decree dissolving a temporary injunction, obtained by bondholders to restrain an execution sale, no relief besides the injunction being asked for, is a final decree.[8]

[1] Bronson *v.* Railroad Co. (1862), 2 Black, 524, 531.

[2] Milwaukee & Minnesota R. Co. *v.* Soutter (1864), 2 Wall. 440.

[3] Whiting *v.* Bank of the United States (1835), 29 Fed. Cases, 1058; s. c. 1 McLean, 249.

[4] Railroad Co. *v.* Swasey (1874), 23 Wall. 405.

[5] First National Bank of Cleveland *v.* Shedd (1886), 121 U. S. 74.

[6] Bronson *v.* Railroad Co. (1862), 2 Black, 524, 528.

[7] Railroad Co. *v.* Bradleys (1868), 7 Wall. 575.

[8] Titus *v.* Mabee (1861), 25 Ill. 232, 257. The court said: "The only relief sought by the bill was to enjoin the sale of the property under the executions, and when the defendants entered their motion to dissolve the temporary injunction, it was for the want of equity appearing on the face of the bill. The motion operated precisely as a demurrer, and by it the defendant admitted the truth of all the allegations relied upon to entitle the complainants to an injunction. The practice is to allow either a demurrer to the bill or a motion to dissolve the injunction, and either course has precisely the same result, so far as the injunction is concerned. On sustaining the demurrer or allowing

Where the only matter before the court for consideration is the accounting of the receiver, an order made and entered finally disposing of that question is a final order in the nature of a final judgment, and appealable.[1]

§ 868. **Decrees on Confirmation of Sale.** — A decree confirming a sale made in pursuance of the order of the court is final,[2] even though it contains the clause, "and the right to make any further order is reserved."[3]

§ 869. **Decrees setting aside Sales not final.** — Except in jurisdictions where appeals are allowed from interlocutory decrees, a decree setting aside a judicial sale and ordering another is not appealable. Such a decree is not final any more than a judgment of reversal with directions for a new trial or a new hearing.[4]

§ 870. **Finality of Decrees providing for a reference to Master.** — This rule has been thus stated by the Supreme Court of the United States in a recent case: "If the court make a decree fixing the rights and liabilities of the parties, and thereupon refer the case to a master for a ministerial purpose only, and no further proceedings are contemplated, the decree is final; but if it refer the case to him, as a subordinate court, and for a judicial purpose, — as to state an account between the parties, — upon which a further decree is to be entered, the decree is not final."[5]

Thus an appeal does not lie from a decree which merely determines the validity of the mortgage, and, without ordering a sale, directs the cause to stand continued for further order and decree upon the coming in of the master's report;[6] nor from

the motion the temporary injunction is in either case dissolved, and if no other relief is sought, the case is virtually at an end. If other relief were sought by the bill, the decree dissolving the injunction could not, however, be regarded as final."

[1] Chandler v. Cushing-Young Shingle Company *et al.* (1895), 13 Wash. 89; s. c. 42 Pac. Rep. 548.

[2] Sage v. Railroad Co. (1877), 96 U. S. 712.

[3] Wetmore v. St. Paul & Pac. R. Co. (1880), 3 Fed. Rep. 181.

[4] Butterfield v. Usher (1875), 91 U. S. 246. In this case the sale had been confirmed by the Special Term of the Supreme Court of the District of Columbia, and vacated by the General Term, the appeal being taken from the latter decree.

[5] McGourkey v. Toledo & Ohio Central Ry. Co. (1892), 146 U. S. 536, giving a full review of the cases; see p. 545. In this case a decree was held not to be final which ordered a receiver to turn over certain rolling-stock to a car trust, but directed a master to determine the rental of the same, etc., and "to determine and report upon all questions and matters of difference between the receiver and the petitioner, growing out of the use and restoration of the rolling-stock."

[6] Burlington, etc. Ry. Co. v. Simmons (1887), 123 U. S. 54, following Parsons v. Robinson (1886), 122 U. S. 112, and distinguishing First Nat. Bk. of Cleveland v. Shedd (1886), 121 U. S. 74.

a decree which, while finding the amount due and ordering it to be paid by a certain day, leaves certain liens and priorities to be ascertained by a master, and which, while it declares the intention of the court to direct a sale at a future time, leaves the master to inquire into and report upon certain facts and report to the court an order of sale of the mortgaged properties, and a form of advertisement therefor.[1]

§ 871. **Appealability of Interlocutory Orders.** — No order is final in such a sense as to constitute a final judgment unless it disposes of the main case so far as there is power in the trial court to decide upon the questions presented by the issues, no matter how clearly and decisively the order may indicate what the judgment may be.[2]

Any order is appealable which, if unreversed, will have the effect of finally establishing the property rights of the parties in regard to its subject-matter. Such is the case with respect to an order made after final decree of foreclosure, providing that the receiver may borrow money and issue first-lien certificates.[3]

When in passing the accounts of a receiver the court charges or refuses to allow items, and he claims that the action of the court does him wrong personally, he may appeal.[4]

[1] Parsons *v.* Robinson (1886), 122 U. S. 112.

Upon the question of finality of decree in railway foreclosure, the case of Compton *v.* Jesup (1897), 167 U. S. 1, is important and instructive. With a view to reorganization, several foreclosure suits were brought to foreclose railway mortgages in different circuit courts of the United States having jurisdiction over the respective railways composing the Wabash system. Decrees were rendered in each suit simultaneously, directing the sale of the entire system as a unit, but protecting, by express provision, a lien upon one of the constituent railways, existing at and prior to the consolidation, and to which the plaintiff had been adjudged entitled in a State court. After the sale and confirmation, it was referred to a special master to determine whether the lien continued in full force and effect. He reported affirmatively, and also that plaintiff was entitled by the decree to a resale of the portion of the road upon which his lien rested if the purchaser failed to pay his bonds, including interest, in full. The court sustained the report as to the validity and subsistence of the lien, but not as to right of resale, holding plaintiff's only remedy was to redeem. Plaintiff appealed to Circuit Court of Appeals, and upon the certificate of that court, propounding questions concerning which instructions were asked, the Supreme Court decided that a resale should have been allowed, as the decree under which the sale was made was "in all essential respects the final decree in the case, the questions reserved being merely incidental to carrying the decree into full effect. And," said the court, "it may well be doubted whether it was competent for the Circuit Court at a subsequent term to disturb the right of Compton (plaintiff), defined and adjudicated at a previous term in the final decree of sale."

[2] Elliot on Appellate Proc., § 83 and following sections.

[3] Farmers' Loan & Trust Co., Petitioner (1888), 129 U. S. 206.

[4] Chicago Title & Trust Co., Receiver, etc. *v.* Caldwell (1894), 58 Ill. App. 219, upon authority of Hinckley *v.* Gilman, etc. R. (1876), 94 U. S. 467; How *v.* Jones (1882), 60 Iowa, 70.

An order authorizing the issue of certificates by a receiver of a railroad corporation, making them a lien upon the *corpus* of the property, and the proceeds to be used in maintenance of the railroad, is appealable.[1] So, also, an order made upon a complaint in intervention by preferred creditors, directing the sale of the rolling-stock to satisfy their claims;[2] an order granting a petition for compensation for services out of the fund in court;[3] and also an order that all further proceedings in the cause shall be stayed until the further order of the court, being equivalent to injunction, within the purview of a statute allowing an appeal in such cases.[4]

On the other hand, orders which determine no right are not appealable. To this class belong orders discharging a receiver;[5] unless in those States in which proceedings as to appointment and removal of receivers are held to be "special proceedings," within the purview of a statute providing that an order made in such proceedings, which affects a substantial right, is appealable.[6]

It has been held that the Code of Maryland, art. 5, § 21, authorizes a decree from an order directing a sale, but not from an order refusing to authorize a sale before final decree, or from an order suspending or rescinding an interlocutory order of sale.[7]

§ 872. **Appeal from one of several Decrees.** — Where several decrees are rendered, the appeal is properly taken from that which finally settles the matters in regard to which the opinion of the appellate court is asked. If, for example, after a foreclosure sale by a junior mortgagee, subject to a first mortgage, an order is made allowing, as commissions to receiver and trustees, an amount in excess of sum bid at sale, and then, after a report of the master and a ratification of the sale, a second decree is rendered that the deficiency in these allowances shall be made up by holders of first-mortgage bonds, an appeal against the ruling of the court in regard to the commissions is properly taken from the last decree. Until that decree is rendered, and

[1] State *v.* Port Royal & A. Ry. Co. *et al.* (S. C., 1895), 23 S. E. Rep. 380.

[2] Radebaugh *v.* Tacoma & Puyallup R. Co. (1894), 8 Wash. 570; s. c. 36 Pac. Rep. 460.

[3] Trustees *v.* Greenough (1881), 105 U. S. 531; Williams *v.* Morgan (1883), 111 U. S. 684.

[4] Pennsylvania Co. for Ins. on Lives and for Granting Annuities *v.* Jacksonville, T. & K. W. Ry. Co. (1893), 55 Fed. 131.

[5] Washington City & Point Lookout R. Co. *v.* Southern Maryland R. Co. (1880), 55 Md. 153; Colegate *v.* Michigan & Lake Shore R. Co. (1873), 28 Mich. 288.

[6] Cincinnati, S. & C. R. Co. *v.* Sloan (1876), 31 Ohio, 1; s. c. 15 Am. Ry. Rep. 376.

[7] Washington City & Point Lookout R. Co. *v.* Southern Maryland R. Co. (1880), 55 Md. 153.

the matter of the reimbursement thus put in shape to be enforced against the parties whose rights are to be affected, there is nothing definitely settled which can be the subject of appeal.[1]

Where the first decree determines, with regard to certain claims, merely that they are valid and constitute a lien on the property superior to that of the mortgage, and provides for a reference to a master in respect to the amounts and ownership of such claims, questions relating to the claims are not in a position to be passed upon by an appellate court, until a second decree is rendered declaring who are the owners and what are the amounts of the claims. Both the existence and the priority of the claims are therefore open for consideration upon the appeal from the second decree.[2]

Conversely, on the principle that, although an act which amounts to the performance of a mere ministerial duty growing out of a decree which is being carried into effect is not appealable, an appeal will, in some cases, be allowed from an order of the court, where it affects important interests or decides matters not before the court, when the first decree was rendered, it is held that the refusal of the court to confirm or complete the sale, on the application of the purchaser, is reviewable on appeal.[3]

Article III. — What Appeal brings up for Review and Effect.

§ 873. **What Rulings of Lower Court reviewable.** — An appeal of "this cause" in general terms brings up the whole cause, as far as it has progressed, and, on the appeal, orders previously made in it can be considered.[4]

Hence, although many orders and decrees, which are made in the progress of the suit, affecting materially the rights of the parties, — such, for example, as the adjudications which the court makes upon exceptions to the reports of masters, often involving the whole matter in litigation, — are not final in the sense in which that word is used in relation to decrees, the court will not confine itself to the examination of the last order or decree which confers the right of appeal. Any other rule

[1] Tome v. King (1885), 64 Md. 166.

[2] Porter v. Pittsburg Bessemer Steel Co. (1887), 120 U. S. 677.

[3] Blossom v. Milwaukee, etc. R. Co. (1863), 1 Wall. 655.

[4] Central Trust Co. v. Seasongood (1888), 130 U. S. 482; s. c. 9 Sup. Ct. Rep. 575.

would, in many cases, deprive the appellant of the entire benefit of his appeal.[1]

But if the appeal is taken, not from the final decree of foreclosure and sale, but from an order confirming the sale merely, and the record discloses no ground upon which the fairness of that final decree can be impeached, objection to the mode of sale cannot be considered, for such errors as exist must necessarily inhere partly in the final decree itself and partly in the interlocutory orders. The authority of the court, therefore, extends no further than to the examination of the exceptions filed to the report of the sale.[2]

§ 874. **Rulings not prejudicial to Appellant not reviewable.** — When the only appeal taken from a decree in foreclosure is by the debtor company, the appellate court will not inquire as to whether the creditor should not have been awarded a larger sum than that found to be due.[3]

§ 875. **Objections not presented to Lower Court not reviewable on Appeal.** — The sole exception to this rule is that objections to the jurisdiction of that court may be examined at any time.[4]

The appellate court will not review an alleged error in the proof of bonds, and the allowance of amounts due holders, if no objection to proof was raised below, and the evidence presented to the master was not before it.[5]

§ 876. **Effect of Appeal on Control of Property.** — After the appeal has been allowed and perfected by the filing of the appeal bond, jurisdiction as to all matters affecting the property — certainly as to all matters of substance — is transferred to the appellate court. Consequently the lower court has then no power to take the property from the hands of the receivers and place it in the hands of the trustees, to be operated in accordance with the terms of the mortgage and in the interest of the bondholders.[6]

But, on the other hand, when a receiver is appointed at the

[1] Milwaukee & Minnesota R. Co. *v.* Soutter, Survivor (1864), 2 Wall. 521.

[2] Turner *v.* Farmers' Loan & Trust Co. (1882), 106 U. S. 557.

Where from the evidence it appears that the plaintiff in an ejectment suit was one of certain corporations afterwards consolidated, the objection that the new corporation had succeeded to plaintiff's right may be first raised on appeal. Wiggins Ferry Co. *v.* Illinois & St. L. R. Co. (1896), 45 N. E. Rep. 285.

[3] Indiana Southern R. Co. *v.* Liverpool, London, & Globe Ins. Co. (1883), 109 U. S. 168.

[4] Elliot on Appellate Proc. § 470.

[5] Indiana Southern R. Co. *v.* Liverpool, London, & Globe Ins. Co. (1883), 109 U. S. 168.

[6] Morgan's La. & Tex. R. & St. Ship Co. *v.* Texas Central Ry. Co. (1887), 32 Fed. Rep. 525.

request of a plaintiff for a purpose ancillary to the main object of the action, and judgment is afterwards rendered in favor of the defendant, an appeal by the plaintiff from the judgment does not deprive the lower court of jurisdiction to hear and determine a motion made by the defendant for the discharge of the receiver.[1]

§ 877. **Decree for Deficiency, when not appealable.** — An appeal may lie from a decree in an equity court, notwithstanding it is merely in execution of a prior decree in the same suit, for the purpose of correcting errors which originated in it; but when such decrees are dependent upon the decree to execute which they were rendered, they are vacated by its reversal; in which case the appeal which brings them into review will be dismissed for want of a subject-matter on which to operate. A decree *in personam* for the amount remaining due upon a mortgage debt after the execution of a decree of foreclosure and sale is of this description; but when rendered in favor of other parties than the complainant, it will be reversed for the same error that required the reversal of the decree of foreclosure and sale.[2]

[1] Baughman, Petitioner, *v.* Superior Ct. (1887), 72 Cal. 572.

[2] Chicago, D. & Vincenues R. Co. *v.* Fosdick (1882), 106 U. S. 47.

CHAPTER XXXIX.

RAILWAY REORGANIZATIONS, RECONSTRUCTIONS, AND COMPROMISE AGREEMENTS.

ARTICLE I. — STATE STATUTE PROVISIONS GOVERNING REORGANIZATIONS.

§ 878. **References to General Statutes governing Reorganizations.** — The legal difficulties attendant upon the purchase of a railroad under foreclosure sale by a number of scattered owners were at first obviated by special enactments conferring the legal *status* of a corporation upon the purchasers. But in this country and England this difficulty is now as a rule provided for by statutes of general application, which in many instances give the stockholders and unsecured creditors an opportunity to share with bondholders in the advantages and benefits of the reconstruction.

A list of these statutes will be found in the subjoined note, together with a reference to some cases in which they have been construed.[1]

[1] *Alabama.* — Code 1886, §§ 1596, 1598. Mobile & Montgomery Ry. Co. *v.* Steiner (1878), 61 Ala. 559.

Arkansas. — Dig. of Stats. (1894), §§ 6178-6187. See Shaw *v.* Railroad Co., 100 U. S. 605, 608; Memphis & Little Rock R. Co. *v.* Dow (1886), 120 U. S. 287; Memphis & Little Rock R. Co. *v.* Railroad Commrs. (1884), 112 U. S. 609, 614, 618.

Colorado. — Mills' Ann. Stats., 1891, §§ 614, 615.

Delaware. — Wilmington R. Co. *v.* Downward (Del., 1888), 4 Ry. & Corp. L. J. 234.

Florida. — Rev. Stats. 1891 (67), § 2241, subd. 10.

Georgia. — Code 1895, Subsections 11 and 12 of §§ 2167, 2168.

Illinois. — Rev. Stats. 1895, p. 1907, ch. cxiv., § 1.

Indiana. — Statutes, 1896, Horner's Annotated Ed., pp. 3946 *et seq.* See Lake Erie & W. Ry. Co. *v.* Griffin, 92 Ind. 487; 17 Am. & Eng. R. R. Cas. 235; 107 Ind. 464; 27 Am. & Eng. R. R. Cas. 394; Board *v.* State, *ex rel.*, 115 Ind. 64.

Iowa. — Code 1880, § 1089; and see McLain's Annotated Code, Statutes Supplement, 1888-1892, p. 99.

Kansas. — Gen. Stats. 1889, pp. 1277 *et seq.*

Kentucky. — Pp. 562, Kentucky Stats. (1894).

Louisiana. — Mars. Index (1895), p. 435; Laws of 1877, ch. xxxviii., p. 48. See Vicksburg, S. & P. Ry. Co. *v.* Elmore, 46 Ann. Rep. (La.) 1237; New Orleans R. Co. *v.* Harris, 27 Miss. 517; 2 Am. & Eng. R. R. Cas. 328.

Maine. — Rev. Stats. 1883, ch. 51, §§ 93, 94, 105, 107.

Maryland. — Pub. Gen. Laws, 1888, art. 23, § 187.

Massachusetts. — Acts 1886, ch. 142.

Michigan. — 1 Annot. Stats., 1882, §§ 3314, 3351. See Mackintosh *v.* Flint & P. M. Co., 32 Fed. Rep. 350; s. c. 34 Fed. Rep. 582; Dexter *v.* Ross, 85 Mich. 370.

Act No. 96 of Feb. 10, 1859 (Comp. L. 2373). See Cook *v.* Detroit Ry. Co., 43 Mich. 349; 9 Am. & Eng. R. R. Cas. 443.

Some special statutes are discussed in Att.-Gen. *v.* Joy, 55 Mich. 94 (pp. 107, 108); 16 Am. & Eng. R. R. Cas. 643 (pp. 651, 652).

Minnesota. — Stats. 1894, pp. 2727-2738. See Wetmore *v.* St. Paul, etc. R. Co., 3 Fed. Rep. 170 (p. 179).

Mississippi. — Thomson, Dillard, & Campbell's Annotated Code, 1892, pp. 2566 *et seq.*

Nebraska. — Act of March 1, 1881, Comp. Stat., ch. lxxii., art. 4. See Chicago & St. Paul R. Co. *v.* Lindston, 16 Neb. 254; 21 Am. & Eng. R. R. Cas. 528; Chicago Kansas R. Co. *v.* Hazels, 26 Neb. 375.

New Jersey. — Gen. Stats. 1709-1895, p. 2690. See State of New Jersey *v.* Mont-

§ 879. **Purchasers organize subject to the Constitutional Provisions in Force when the Reorganization is effected.** — Purchasers organize subject to certain constitutional provisions and not merely to those provisions by which the rights of the original

clair R. Co., 43 N. J. L. 524; 13 Am. & Eng. R. R. Cas. 390; Boylan *v.* Kelly, 9 Stewart, 335.

New York. — Stock Corporation Law, 1890, 1892, § 3, and amending acts; Business Corporation Law, 1892, par. 4, and ch. 565, pars. 83, 84, Laws of 1890. For rulings in these statutes, see Metz *v.* Buffalo R. Co., 58 N. Y. 81; Abbott *v.* Jewell, 25 Hun, 603; Thornton *v.* Wabash Ry. Co., 81 N. Y. 462; 6 Am. & Eng. R. R. Cas. 602; Pratt *v.* Munson, 84 N. Y. 582; Harpending Co. *v.* Munson, 91 N. Y. 650; People *v.* Brooklyn, F. & C. I. R. Co., 89 N. Y. 75; Vatable *v.* N. Y., L. E. & W. R. Co., 96 N. Y. 499; 9 Am. & Eng. R. R. Cas. 454, reversing 11 Abb. N. C. 133 and 31 Hun, 316.

People *v.* O'Brien, 111 N. Y. 43, 47; James *v.* Cowing, 82 N. Y. 449; 2 Am. & Eng. R. R. Cas. 336.

People *ex rel.* Schwarz *v.* Cook, 110 N. Y. 443, affirming 47 Hun, 467; Conant *v.* Nat. Ice Co., 8 J. & S. 83, 86.

The reorganization of a corporation under the provisions of chap. 691, Laws of New York, 1892, known as "Business Corporations' Law," "cannot be deemed the formation of a new corporation, but should be regarded as the continuation of the existing one." Putnam, J., in the matter of the application of The Consolidated Kansas City Smelting and Refining Co., etc. (1897), 13 App. Div. 50.

In Fernschild *v.* D. G. Yuengling Brewing Co. (1896), 40 N. Y. Supp. 1119, the reorganized company was held to have assumed all the debts and liabilities of the old company, including its bonds, upon a construction of the whole agreement.

North Carolina. — Laws 1883, ch. 49, § 1936. See Matthews *v.* Murcheson, 15 Fed. Rep. 691, p. 692.

Ohio. — Bates' Annotated Stats., 1897, ¶¶ 3393 *et seq.* McHenry *v.* N. Y., P. & O. R. Co., 25 Fed. Rep. 65, 66; State *v.* McDaniel, 22 O. S. 354.

In the absence of statutory authority a corporation cannot make its preferred stock a lien upon its property. Continental Trust Co. *v.* Toledo, St. L. & K. C. R. Co. (1896), 1 Ohio, 7 D. 321.

The obligations of a railroad company to the public cannot be discharged by a transfer of its franchises to another company, except by legislative enactment authorizing such transfer, and a release to the public from the obligations of the company. Fisher *v.* B. & O. Ry. Co. (1897), 6 Ohio Dec. 67.

Pennsylvania. — April 17, 1876 (Pamphlet L., 33), Act of March 14, 1861. See Wellsborough & Plank Road Co. *v.* Griffin, 57 Pa. St. 417; Commonwealth *v.* Central Passenger Ry., 52 Penn. St. 506.

Act of March 24, 1865. See Pittsburg, etc. Ry. Co. *v.* Fierst, 96 Pa. St. 144; 9 Am. & Eng. R. R. Cas. 437; Landis *v.* West Pennsylvania Ry. Co., 133 Pa. St. 579.

South Carolina. — Rev. Stats. 1893, pp. 1610 *et seq.*; Columbia, etc. Ry. Co. *v.* Gibbs, 24 S. C. 70.

Tennessee. — Code 1896, pp. 1513a *et seq.* See Mayor of the City of Knoxville *v.* Knoxville & Ohio Ry. Co., 22 Fed. Rep. 758.

Texas. — Paschal's Dig. 1866, p. 820, 4912, 4916; Tex. Rev. Stats., art. 4260, 4264. See as to the constructions of this statute, Witherspoon *v.* Texas Pacific R. Co., 48 Tex. 309; Carey *v.* Houston T. C. Ry. Co., 45 Fed. Rep. 438, 441; Acres *v.* Mayne, 59 Tex. 623, 625, 626; Houston R. Co. *v.* Shirley, 54 Tex. 125, 139; 4 A. & E. 443.

Utah. — 2 Corp. Laws, 1888, § 2573.

Vermont. — R. L. 1880, §§ 3461, 3475. Statutes, 1894, Reorganization of street-railway companies after foreclosure, pp. 3950–3976.

Virginia. — Code 1887, § 1233, amending acts 1891–1892, p. 623.

The provisions of the Code of Virginia, § 1234, respecting reorganization, do not impose on a new company any duty to maintain branch roads unless the old company was bound so to do prior to the mort-

company were governed. This rule prevails even though the statute authorizing the mortgage contemplates the formation of a new body to exercise the franchise of the mortgagor after they have been transferred by a foreclosure sale. "A statutory provision for becoming a corporation *in futuro* does not become a contract in the sense of that clause of the Constitution of the United States which prohibits impairing its obligation, until it has become vested as a right by an actual organization under it; and then it takes effect as of that date, and subject to such laws as may then be in force. The stipulation, whatever its

gage, the foreclosure whereof brought about the succession. Sherwood *v.* Atlantic & D. R. Co. (1897), 26 S. E. Rep. 943.

West Virginia. — Code 1887, ch. 54, §§ 72, 73. See Chesapeake & Ohio Ry. Co. *v.* Miller, 114 U. S. 176.

Wisconsin. — Rev. Stats. 1878, § 1828. See Smith *v.* Chicago & N. W. Ry. Co., 18 Wis. 18; Neff *v.* The Wolf River Boom Co., 50 Wis. 585; City of Menasha *v.* Milwaukee & North R. Co., 52 Wis. 414, 421; 5 Am. &. Eng. R. R. Cas. 300; Gilman *v.* The Sheboygan, etc. R. Co., 37 Wis. 317, 319.

England Joint Stock Companies Arrangement Act, 1870. — In England reorganization, or as it is there termed, reconstruction, is accomplished chiefly under the provisions of the above act.

Under this act, with the consent of the court, a company has the same power to compromise as an individual. *Re* Albert Life Assn. Co. (1871), 6 Ch. App. 381.

A perfected scheme of reconstruction under the English act of 1870 has the effect of discharging the company from all liability. *In re* London Chartered Bank of Australia (1893), 3 Ch. 540.

Companies Act of 1862. — Under this act, a sale of the company's assets and a compromise of its debts and liabilities may be effected. *Re* Albert Life Assn. (1871), 6 Ch. App. 381; *In re* Alabama, N. Y. & P. J. Ry. Co. (1891), 1 Ch. 236.

In arriving at the meaning of the word "reorganization" or "reconstruction," the question to be asked is whether the new company is practically the same as the old even though in law it is a separate corporation. It does not include "amalgamation." Hooper *v.* Western Counties Tel. Co. (1892), 41 W. R. 84.

Winding-up Proceedings. — In a winding-up proceeding with a view to reconstruction it is not competent for a majority of shareholders to give a benefit to one class of shareholders over the other. Simpson *v.* Palace Theatre, Limited (1893), W. N. 91.

Debentures become payable immediately upon a resolution taking effect, for a voluntary winding up, when it is conditioned that "if the company commences to be wound up otherwise than for the purposes of reorganization or reconstruction" the principal shall become immediately payable. Hooper *v.* Western Counties Tel. Co. (1892), 4 W. N. 84.

A winding-up order may be limited to a particular purpose, as for the collection of assets, payment of debts, etc. *In re* Western of Canada Oil Co. (1874), W. N. 148.

The court will discharge a winding-up order where there has been a compromise effected satisfactory to the large majority in amount of the creditors. *In re* Patent Automatic Knitting Co. (1882), W. N. 97.

Other Methods of Reconstruction. — Besides the proceedings under the Arrangement Act of 1870, reconstruction may be accomplished in pursuance of the provisions of the agreement of association; or under section 161 of the Companies Act of 1862. Cotton *v.* Imperial Agency (1892), 67 L. T. R. 392.

See also 30 & 31 Vict. 127 (1867), §§ 6–16; London Financial Assn. *v.* Wrexham Ry. Co., L. R. 18 Eq. 566; *In re* Devon R. Co., L. R. 6 Eq. 610 & 615; *In re* Bristol & N. S. Ry. Co., L. R. 6 Eq. 448; *In re* Cambrian Ry. Co.'s Scheme, L. R. 3 Ch. 278; Munns *v.* Isle of Wight Ry. Co. L. R. 8 Eq. 653; Stevens *v.* Mid. Harts Ry. Co., L. R. 8 Ch. 1064.

form, must be construed as subject and subordinate to the paramount policy of the State, and to the sovereign prerogative of deciding in the mean time what shall constitute the essential characteristics of corporate existence. The State does not part with the franchise until it passes to the organized corporation, and when it is thus imparted, it must be what the government is then authorized to grant and does actually confer."[1]

§ 880. **Distinction between Incorporation and Organization of New Company.** — Irregularities in the organization of a corporation under the Pennsylvania Statute of April 8, 1861, are not necessarily fatal to its being. Organization is but the creation of an agency by which the corporate body can act. It presup-

[1] Memphis & Little Rock Ry. Co. *v.* Railroad Commrs. (1884), 112 U. S. 609, per Matthews, J., citing with approval the following passage: "The real transaction, in all such cases of transfer, sale and conveyance, is nothing more or less, and nothing other than a surrender or abandonment of the old charter by the corporators and a grant *de novo* of a similar charter to the so-called transferees or purchasers. To look upon it in any other light, and to regard the transaction as a literal transfer or sale of the charter, is to be deceived by a mere figure or form of speech. The vital part of the transaction, and that without which it would be a nullity, is the law under which the transfer is made. The statute authorizing the transfer and declaring its effect is the grant of a new charter couched in few words and to take effect upon condition of the surrender or abandonment of the old charter; and the deed of transfer is to be regarded as mere evidence of the surrender or abandonment." State *v.* Sherman (1872), 22 Ohio St. 411, 428. In Memphis & Little Rock Ry. Co. *v.* Railroad Commrs., *supra*, it was held that the purchasers not having become a corporate body until after the Arkansas Constitution of 1874, prohibiting the legislature from surrendering or suspending the right to tax corporate property, took effect, did not succeed to the privilege of immunity from taxation enjoyed by the original company. To the same effect as regards the general effect of the enactment of a new constitution, see Central Railroad Bk. Co. *v.* Georgia (1875), 92 U. S. 665.

As to the effect of the enactment of new constitutional provisions upon the right to claim the same exemption from taxation as was enjoyed by the mortgagor company, see Chap. XXXIV.

A "reincorporation," to use the statutory term, under the 4th section of the Business Corporation Law of New York (chap. 691, Laws of 1892), of a concern incorporated originally under the general manufacturing act of 1848, is not the creation of a new corporation liable to pay an organization tax. It is a corporate act effected by a vote of a majority of the stockholders, instead of the directors through whom the corporation ordinarily acts. A "consolidation" under the 8th section of the act of 1892 is also a corporate act, also to be performed through the stockholders direct. But it creates a new corporation required by the provisions of chap. 668, Laws of 1892, to pay an organization tax, but only upon the excess of its capital stock over the aggregate amount of its constituent corporations. A reincorporation under the 4th section is but the continuance of an existing corporation; a consolidation under the 8th section is the formation of a new company. Both, however, are to be distinguished from a reorganization under the reorganization act (chap. 430, Laws of 1874, and amending acts) of a corporation to be composed of new stockholders with a new capital and without provision for the continuance of the former corporation to whose property and franchises it succeeds. *In re* the Application of the Consolidated Kansas City Smelting & Refining Company (1897), 13 App. Div. 50.

poses the existence of the artificial person. Hence where a statute declares that the purchasers of a railroad at a judicial sale are by that purchase constituted a body politic and corporate, directions as to subsequent organization are not conditions of being, as they possibly might be if the purchasers did not take by succession. The utmost effect of not following those directions strictly can be no more than to work a forfeiture of the franchise. It cannot entitle the State to a judgment that the franchise has no existence.[1]

§ 881. **Existing Company not prevented by General Reorganization Statutes from purchasing.** — The provisions of the New York Railroad Acts, authorizing the purchaser at foreclosure sale of the property and franchises to organize a new corporation, are intended to meet cases where there is no corporation in existence to take over the road, and do not prevent an existing corporation from purchasing the property and exercising the franchises which pass to purchasers.[2]

§ 882. **Special Statutes governing Reorganizations.** — (a) *As affected by the United States Constitution.* — Minority bondholders cannot be compelled to reorganize under a special law against their will. But it is competent for the legislature to provide that the assent of any bondholder to a reorganization scheme shall be conclusively presumed, if he fails to give notice of his dissent within three months or any reasonable period. The principle by which abandonment of rights is presumed after a fixed period is analogous to that which underlies and upholds the statutes of limitation, and in no sense is there a violation of the constitutional provision respecting the impairment of contractual obligations.[3]

The property rights of persons holding bonds secured by a mortgage on a railroad are subordinate to the right of the public to have railroad property remain pledged to the public use to which it has been once devoted. Accordingly, when a railroad company fails and a strict foreclosure has been had under the laws of Connecticut, the legislature has full power to authorize the bondholders, by a vote of the majority and with equal opportunity to all, to reorganize as a new corporation with the rights of the old corporation. The action so authorized is merely a mode of securing the performance of the public trust undertaken

[1] Commonwealth *v.* Central Passenger Ry. (1866), 52 Pa. St. 506.

[2] People *v.* Brooklyn, Flatbush, & Coney Island Ry. Co. (1882), 89 N. Y. 75; s. c. 9 Am. & Eng. R. R. Cas. 454.

[3] Gilfillan *v.* Union Canal Co. of Pennsylvania (1883), 109 U. S. 401.

by the mortgagor company which is superior to the rights of the bondholders.[1]

(b) *Rule in Countries where there is no Provision against impairing the Obligation of Contracts.* — There being no constitutional prohibition in Canada against the passage of statutes impairing the obligation of contracts, and Parliament having exclusive legislative authority over the corporation and its bankruptcy and insolvency, a statute providing schemes of reorganization, wherein the minority may be bound in a reasonable way by the majority, is valid. Bondholders are interested in the administration of a trust created for the common benefit, and there may be legislative supervision for the good of all. Such regulations do not deprive a person of his property without due process of law. They simply require him to conduct himself for the general good and not unnecessarily to injure others. International comity requires that such a scheme legalized in Canada should be recognized here.

Each bondholder impliedly subjects himself to such foreign laws affecting the powers and obligations of the corporation with which he voluntarily contracts, as the humane and established policy of that government authorizes.[2]

§ 883. **Statutory Provisions must be strictly complied with by any one taking Advantage of them.** — The ordinary rule is, that unless some statute intervenes, the foreclosure of a railroad mortgage cuts off all the rights and interests of the mortgagor, and leaves nothing for the general creditors and stockholders of the company, except their interest in any surplus that may remain after satisfying the mortgage. A statutory provision whereby the purchasers are allowed to buy, not absolutely for themselves,

[1] Gates *v.* Boston & New York Air Line R. Co. (1885), 53 Conn. 333, 347. In this case the court laid some stress on the fact that in Connecticut the practice of selling property on foreclosure had not been adopted, the effect of foreclosure being simply to shut off the mortgagor's equity of redemption, and place the mortgagee in the same relation with regard to the mortgaged property as had previously been occupied by the mortgagor. The title to the property, therefore, vested in the trustee in trust for the bondholders, and the trustee and the beneficiaries of the trust continued to hold that property subject to the same limitations, duties, and obligations that had vested upon the original corporation. But the decision seems to be independent of this special consideration.

[2] Canada Southern Ry. Co. *v.* Gebhard (1883), 109 U. S. 527; s. c. 14 Am. & Eng. R. R. Cas. 581. The questions in this case which were passed upon by the U. S. Supreme Court were (1) whether the "Arrangement Act" was valid in Canada and had the effect of binding non-assenting bondholders within the dominion of the terms of the scheme, and (2) whether, if it did have that effect in Canada, the courts of the United States should give it the same effect as against citizens of the United States whose rights accrued before its passage; and each was answered affirmatively.

but in pursuance of a specified plan for the readjustment of the respective interests of the mortgage creditors and stockholders, does not change this principle. The property will still pass absolutely, and all the proper rights of the stockholders are cut off by the sale. Such a plan has reference only to the new corporation to be formed and to the interests therein. If the stockholders are, by the provisions of the plan, to have the right to assent to it at any time within six months after the formation of that corporation, it is a condition precedent to the exercise of that right that he shall signify his assent within that time, and equity cannot relieve him from the performance of that condition.[1]

Neither actual notice of the terms of such a plan, nor any legal proceedings, are required in order to bar the rights of the stockholders after the expiration of the time fixed by the statute. Nor can a provision in the plan itself, to the effect that payments by stockholders in respect to their stock may be made "before the expiration of such time as may be lawfully limited" by the promoters of the plan, be construed as meaning anything more than that the time should be limited by a majority of those promoters at a meeting regularly called, or be fixed with reference to the statutory period of six months.[2]

§ 884. **Statutes prohibiting Fictitious Increase of Stock.** — The common statutory or constitutional provisions prohibiting corporations from issuing stock or bonds, except for money or property actually received or labor done, and forbidding all fictitious increase of stock or indebtedness, have no application to a transaction the effect of which is that purchasers at foreclosure sale are to transfer to the newly organized company the rights, etc., of the old company acquired by such sale, and receive therefor a certain amount of the stock and mortgage bonds of the new company. The reason is that the transaction is a real one, based upon a present consideration, and having reference to

[1] Vatable *v.* New York, Lake Erie, & W. R. Co. (1884), 96 N. Y. 49; s. c. 17 Am. & Eng. R. R. Cas. 268, reversing 31 Hun, 316. The New York Statute of 1853, in reference to the foreclosure of mortgages providing that a stockholder might, by paying to the purchaser a proportion of the price equal to the proportion his stock bore to the entire corporate stock, acquire the same relative amount of stock or interest in the road, has been held to have been repealed by the Statute of 1854, amending the general Railroad Act, and by the Statute of 1874, "To facilitate the organization of railroads, etc." The latter statutes confer upon the purchaser rights so entirely repugnant to those bestowed by the first statute upon the stockholders that a repeal by implication has been presumed. Pratt *v.* Munson (1886), 84 N. Y. 582.

[2] Vatable *v.* New York, Lake Erie, & W. R. Co. (1884), 96 N. Y. 49; s. c. 17 Am. & Eng. R. R. Cas. 268.

legitimate corporate purposes and not a mere device to evade the law.[1]

§ 885. **Statutes fixing Rate of Interest on Loans.** — Bonds issued in a transaction of the kind mentioned in the preceding section will not be invalid because made to bear a rate of interest higher than that specified in an act which authorizes railroad companies to borrow money and mortgage their property, etc., to secure the loan. Such bonds are not executed for money borrowed, but for property conveyed at an agreed price to be paid for in stock and bonds.[2]

§ 886. **Statutory Powers of a Majority of Security Holders in England.** — This power extends to debenture-holders, although it deprives them of their security.[3]

This power (of the majority to bind) must be construed strictly. Thus "the power to release the mortgaged premises does not include a power to release the defendant company. The power to modify the rights of the debenture-holders against the company does not include a power to extinguish all their rights.[4]

But it has been held that the power "to sanction any modification or compromise of the rights of debenture-holders against its property" authorized the issue of a new loan to take priority over existing debentures.[5]

In England, under section 15 of the Railway Companies Act of 1867, a three-fourths majority is indispensable to bind a particular class, as debenture-holders, etc., unless the court can say as a matter of law that no rights or interests of the class are prejudicially affected.[6]

[1] Memphis & Little Rock R. Co. *v.* Dow (1887), 120 U. S. 287, followed in Mackintosh *v.* Flint & Pere Marquette R. Co. (1888), 34 Fed. Rep. 582; s. c. 36 Am. & Eng. R. R. Cas. 340; s. p. Cushman *v.* Benfield (1889), 36 Ill. App. 436.

[2] Memphis & Little Rock R. Co. *v.* Dow (1887), 120 U. S. 287.

In England by the Joint Stock Companies Arrangement Act of 1870 power is given to the majority, representing three-fourths in value of a company's creditors to bind the minority with the consent of the court. *In re* Albert Life Assn. (1871), 6 Ch. App. 381; *In re* Bessemer S. & O. Co. (1875), 1 Ch. D. 251.

The reason of this was the difficulty of dealing with debenture-holders as a class. *In re* Dominion of Canada F. & T. Co. (1886), 55 L. T. R. 347.

A majority means of those at meeting, not of all creditors. *In re* Bessemer Steel & O. Co. (1875), 1 Ch. D. 251.

[3] *In re* Alabama N. O., T. & P. J. Ry. Co. (1891), 1 Ch. 236; *In re* Dominion of Canada F. & T. Co. (1886), 55 L. T. Rep. 347; *In re* Empire Mining Co. (1890), 44 Ch. D. 409; *In re* Dynevor D. & N. A. Collieries Co. (1879), 11 Ch. D. 605.

[4] Investment & Gen. Trust Co. *v.* International Co. (1893), 1 Ch. 484, note.

[5] Follet *v.* Eddystone Granite Quarries (1892), 3 Ch. 75.

[6] *In re* Neath & Brecon Ry. Co. (1892), 66 L. T. 356.

Compare by way of illustration the holding that a deed of arrangement agreed to by the statutory majority of life-policy-holders, whose policies have not matured, does not bind the holder of a policy which matured before the date of the deed.[1]

On the subject of statutory meetings of bondholders —

The court will direct separate meetings of the several classes of creditors.[2]

A creditor who is also a shareholder is entitled to attend a creditors' meeting.[3]

To prevent fraud, the holder of debentures which pass by delivery should produce their debentures at the meeting to entitle them to vote.[4]

Under the Arrangement Act of 1870 it is not obligatory to produce written proxies.[5]

For the purposes of a meeting of any particular class of persons, proxies can only be given to and held by members of that class. Accordingly proxies given to an official liquidator who was not of the class were held invalid.[6]

On a reconstruction under the Joint Stock Companies Arrangement Act proxies must be in the form approved by the court.[7]

Article II. — Mortgage Provisions governing Reorganizations.

§ 887. **Mortgage Provisions as to Distribution of Stock in New Company.** — A mortgage executed by the New York and New England Railroad Company provided that the trustees might take possession, for the purpose of foreclosure, upon default in payment of principal or interest of the bonds, and that, when the foreclosure became absolute through the continuance of the default for a certain time, the bondholders might form themselves into a new corporation, with a capital stock equal to the mortgage debt, at a meeting at which each bondholder should be entitled to cast one vote for "every one thousand dollars principal sum of such bonded debt held by him." It was also provided that the new corporation should consist of the holders of the mortgage bonds "at the rate of ten shares for every bond

[1] Sovereign Life Assn. Co. *v.* Dodd (1893), 4 R. 17.

[2] Slater *v.* Darlaston Steel Co. (1877), W. N. 165.

[3] *In re* Madras Irrigation & Canal Co. (1881), W. N. 172.

[4] *In re* Wedgwood Coal & Iron Co. (1877), 6 Ch. D. 627.

[5] *In re* English, Scottish, and Australian Chartered Bank (1893), 3 Ch. D. 409.

[6] *In re* Madras I. & C. Co. (1881), W. N. 120.

[7] Inter-Oceanic Ry. of Mexico (1896), 3 Manson, 162.

of one thousand dollars, as said bonds shall be surrendered to said new corporation to be exchanged for certificates of stock at the rate aforesaid." While the mortgage was in force, a contract was entered into with another company, whereby the latter agreed to pay the interest on a portion of the bonds as it matured, this contract to be indorsed on those bonds. The contract also provided that any interest which the guarantor company was obliged to pay should be a valid lien on all the property secured by the mortgage. It was held (1) that the capital stock of the new corporation was to be determined by the principal sum of the mortgage debt, without regard to the unpaid interest; (2) that a holder of bonds issued under the contract with the second company, and who had received the interest from that company, was entitled to ten shares of stock for each bond; (3) that the guarantor company was not entitled to any stock, and that a person to whom the guarantor had sold coupons when overdue had no greater rights than his transferor.[1]

§ 888. **Rights of Majority under Mortgage or Debenture Provisions.** — If the majority of the bondholders are by the mortgage authorized in broad words to define the "terms, conditions, and limitations," under which the new company shall be organized, a decree embodying the wishes of such majority and reserving a controlling interest to the class of lien-holders for whose benefit the reorganization is carried out, cannot be objected to on the ground that it also concedes entirely subordinate interests in the new corporation to junior incumbrancers and to the stockholders of the old corporation. The rights of the minority are not thereby sacrificed to those of other creditors or in any way interfered with. Such concessions are generally made in reorganizations of railroad companies, and as they prevent the delay and expenditure often ruinous, arising out of litigation between creditors, and lessen the risk of redemptions, are regarded as beneficial to the whole body of lien-holders.[2]

[1] Child *v.* New York & New England R. Co. (1880), 129 Mass. 170; s. c. 2 Am. & Eng. R. R. Cas. 329 (1880).

[2] Sage *v.* Central Railroad Co. (1879), 99 U. S. 334.

The holders of debentures containing a provision that a majority of three-fourths should have power "to compromise the rights of the debenture-holders against the property of the company" have the power, with the requisite majority, to sanction a scheme of reconstruction whereby the new company should take over the property free from the debenture charges, the debenture-holders receiving fully paid shares in the new company, where this was necessary to avoid the forfeiture of valuable property. Sneath *v.* Valley Gold, Limited (1893), 2 R. 292.

ARTICLE III. — AGREEMENTS BETWEEN PARTIES HAVING INTERESTS IN MORTGAGED PROPERTY GOVERNING REORGANIZATION.

§ 889. **General Considerations.** — It is well settled that bondholders and stockholders may unite for the purchase of the property, at a sale made in good faith, to prevent a sacrifice thereof. The fact that the purchase is made in pursuance of a reorganization agreement entered into prior to the sale does not in itself make the sale a fraud upon the rights of a non-assenting creditor, nor entitle him to demand the payment of his debt by the new company.[1]

An agreement was entered into between stockholders, bondholders, and creditors, of an insolvent company, to unite in buying in the property, and to distribute the stock and bonds of the new company among all those who signed the agreement according to a certain scheme. It was signed by all the stockholders, nearly all the bondholders, and all the creditors except the complainant. It was held that as there was nothing hurried or secret about the transaction, and the complainant had ample opportunity to bid at the sale, he could not maintain a bill to establish a trust as against the parties to the agreement, or compel them to pay the amount of his judgment, especially where he had lain by for three and a half years, and allowed the new company to be organized without objection.[2]

The court itself has no power to fix a basis for the common action of creditors. It is the subject of mutual agreement.[3]

But a reorganization decree may be treated as a contract between the bondholders and stockholders who are parties to it.[4]

The prevention of costly litigation which must ensue, if stockholders and creditors whose interests are subordinate to those of bondholders persist in asserting their claims, is regarded as a sufficient consideration for reorganization agreements by which bondholders surrender a portion of their paramount rights in the property.[5]

An agreement by the stockholders to assent to the foreclosure and surrender their certificates of stock is a sufficient consideration to support a stipulation whereby they are to be given the

[1] Pennsylvania Transportation Co.'s Appeal (1882), 101 Pa. St. 576.

[2] Ibid.

[3] Wabash, St. Louis, & Pacific R. Co. *v.* Central Trust Co. (1884), 22 Fed. Rep. 138.

[4] Mackintosh *v.* Flint & Pere Marquette R. Co. (1887), 32 Fed. Rep. 350. See this case in 34 Fed. Rep. 582.

[5] Sage *v.* Central Railroad Co. (1879), 99 U. S. 334, per Strong, J. (p. 344).

standing of common stockholders in the new corporation, especially when the agreement provides an additional security for the bondholders by the conveyance to them of certain surplus land grants and land grant funds.[1]

Under a reorganization agreement where bonds secured by a prior mortgage are surrendered to a committee of bondholders who are authorized by the agreement to hold those bonds as an additional security for those surrendering them for new bonds secured by a consolidated mortgage, such a surrender of the bonds will not amount to an extinguishment of them and their lien, and thus give non-assenting bondholders a right to enforce the first or prior lien for their benefit at once. The rule of law in such a case is thus stated by Jenkins, C. J.: "When a novation is thus sought to be established, it must be shown that the substitution of the new obligation was with design and intent to extinguish the old obligation; and as such an act would, upon its face, appear to be against the interest of the holder of the bond, such intent will not be presumed but must be clearly established. A mere change in the form of the mortgaged debt, such as the substitution of new bonds for those originally secured by it, would not extinguish or affect the lien."[2]

Section 1628 of the New York Code of Civil Procedure which prohibits the maintenance of an action to recover the mortgage debt after foreclosure, without leave of court, applies only to the original obligation, not to an action based upon a reorganization agreement resulting from the foreclosure. Such an action may be maintained without leave of the court.[3]

Upon a resale for a less price of a railroad after a reorganization committee had failed to make good its bid at a former sale, the committee is bound to make up the difference in the interests of unsecured creditors.[4]

§ 890. **Reorganization Agreements are favorably viewed by the Courts.** — The courts favor reorganization agreements. In de-

[1] Mackintosh *v.* Flint & Pere Marquette R. Co. (1888), 34 Fed. Rep. 582; s. c. 36 Am. & Eng. R. R. Cas. 340.

[2] Mowry *v.* Farmers' Loan & Trust Co. (1896), 76 Fed. Rep. 38, 43; upon authority of Stevens *v.* Railway Co., L. R. 8 Ch. App. 1064. See also Barry *v.* Missouri, K. & T. Railway Co. (1888), 34 Fed. Rep. 829, 833; Ames *v.* Railway Co. (1876), 2 Woods, 207; s. c. Fed. Cas. No. 329; Fidelity Ins. Trust & Safe Deposit Co. *v.* Shenandoah Valley Ry. Co., 86 Va. 1; s. c. 9 S. E. Rep. 759; Ketchum *v.* Duncan, 96 U. S. 659. In the case of Union Trust Co. *v.* Illinois Mid. Ry. Co., 117 U. S. 434; s. c. 6 Sup. Ct. Rep. 809, there was no contingency and no reservation on the part of those surrendering bonds. The surrender was for cancellation, and there was cancellation. That was a case of novation pure and simple.

[3] Fernschild *v.* D. G. Yuengling Brewing Co. (1836), 40 N. Y. Supp. 1112.

[4] Central Trust Co. *v.* Cincinnati, etc. Ry. Co. (1892), 58 Fed. Rep. 501.

ciding that general mortgagees had no right to foreclose the prior underlying mortgages, Judge Baxter placed his decision upon the theory that the valuable protective power of a reorganization agreement in the case before him would be practically destroyed by permitting the property to be sold as an entirety, as no basis of co-operation could be reached by the several mortgages.[1]

Combinations between creditors, formed to reorganize insolvent corporations, ought, when legal and proper, to be promoted and encouraged, inasmuch as they are often necessary to prevent the corporate property from being sold at a sacrifice.[2]

There is no reason why some of the bondholders should not take steps to have the road sold, and to buy it as cheap as they can, provided they do not cheat or hinder anybody in the matter.[3]

Especially is there no ground for regarding such action as fraudulent, where the bondholders who co-operate with a view to the purchase of the road invite all the others to join the combination.[4]

Such an agreement does not deprive the other bondholders of any of their rights. They are at liberty to join the combination, or, if they decline to do this, the combination still leaves them free to protect their interests by bidding at the sale.[5]

The pendency of a reorganization scheme looking to the preservation of a whole system, as an entirety, may sometimes be a reason for refusing temporarily an application of the trustees of one of the divisional mortgages to be put in possession.[6]

§ 891. **Power of Majority of Bondholders under Agreement.**[7] — The most that the non-assenting bondholders can claim is that they shall not be prejudiced by the new arrangement. Thus, they are entitled to be paid out of the proceeds of a sale of the

[1] Wabash, St. Louis, & Pac. Ry. Co. *v.* Central Trust Co. (1884), 22 Fed. Rep. 138; Central Trust Co. *v.* U. S. Rolling Stock Co. (1893), 56 Fed. Rep. 5.

[2] Central Trust Co. *v.* United States Rolling Stock Co. (1893), 56 Fed. Rep. 5; Robinson *v.* Philadelphia & Reading Ry. Co. (1886), 28 Fed. Rep. 340.

In the latter case the court declined to grant an order to answer interrogatories on the ground that the inquiry thus proposed to be made as to the private affairs of the organization formed for the purchase of a road might tend to defeat the objects of the sale contemplated.

[3] Wetmore *v.* St. Paul & Pac. R. Co. (1880), 3 Fed. Rep. 177; Kropholler *v.* St. Paul & Pac. R. Co. (1880), 2 Fed. Rep. 302.

[4] Wetmore *v.* St. Paul & Pac. R. Co. (1880), 3 Fed. Rep. 177.

[5] Kropholler *v.* St. Paul & Pac. R. Co. (1880), 2 Fed. Rep. 302.

[6] See Chap. XVII. (Suits for Possession).

[7] See also *post* as to compromise under statute.

mortgaged property such part as they would have been entitled to if the new bonds and new trust deed had not been executed.[1]

Where in England under the Act of 1867 the instrument defining the powers of debenture-holders provides that a majority of three-fourths in value may compromise the rights of the whole class against the company or the property, the minority are not bound by the action of the majority, unless there is an actual difficulty in enforcing the secured debt, which cannot be got over without some arrangement, for it is only of such a case that the word "compromise" can be properly used.[2]

§ 892. **Subscribers to Agreement not bound unless it is carried out substantially as made.** — A compromise agreement between the company and its creditors, the object of which is to substitute a new mortgage for the original ones, and thus place the creditors on a common footing, is not binding on the subscribers, if, in carrying it out, there is any substantial departure from its terms.[3]

Where parties enter into an agreement by which the bonds of an old railway company which is insolvent are to be paid by an issue of bonds of a reorganized company, and an issue of stock of the latter in payment of the other obligations of the old company, and the agreement is carried out in the reorganization of the company with a full knowledge of all the material facts as to the obligations of the old company, the new company is bound to issue its stocks to a construction company for its full claim against the old, and will be estopped

[1] Ames *v.* Ry. Co. (1876), 1 Fed. Cas. 329. See an editorial in The Commercial & Financial Chronicle of July 3, 1897, Vol. 65, p. 8, bearing upon this subject.

[2] Sneath *v.* Valley Gold (Limited), (1893), C. A., L. R. 1 Ch. 477; s. c. 40 Am. & Eng. Corp. Cas. 337, note.

The English Companies Act of 1870, authorizing a three-fourths majority of a meeting of the creditors, or of a single class of creditors, of a company which is being wound up, to agree to a compromise or arrangement which, if sanctioned by the court, is binding on all the creditors or class of creditors, as the case may be, is applicable to holders of debentures. In exercising its power of sanctioning a scheme of arrangement the court will not only ascertain that all the statutory conditions have been complied with, but will also consider whether the class of creditors summoned to the meeting was fairly represented by those who attended, and whether the statutory majority who approved of the scheme were acting *bona fide*, or were seeking to promote interests adverse to those of the class whom they professed to represent, and generally whether the arrangement is such as a man of business would reasonably approve. *In re* Alabama, etc. Ry. Co. (1891), C. A., L. R. 1 Ch. 213, approving *In re* Empire Mining Co., 44 Ch. Div. 402.

This act does not authorize a majority of creditors to bind the minority as in the case of an arrangement under the Joint Stock Companies Arrangement Act of 1870. *In re* Albert Life Assn. (1871), 6 Ch. App. 381; *In re* Alabama, U. T. & P. J. Ry. Co. (1891), 1 Ch. 236.

[3] Miller *v.* Rutland & Washington R. Co. (1867), 40 Vt. 399.

to defend in an action to compel the performance of the agreement, on the ground that stock in the old was issued to too great an amount for the construction work done by the construction company.[1]

A reorganization committee of bondholders were by their agreement fully empowered to adjust, compromise, etc., claims against the company. The bonds of the bondholders were surrendered to them; they entered into negotiations with the holders of preferential claims and agreed that the latter should assign their claims to the committee and receive from the company therefor negotiable certificates for certain sums payable in cash to be secured by the bonds in the hands of the committee. The holders of the claims assigned them to the committee as they had agreed, but the committee did not deliver the certificates called for by their contract. There was a foreclosure and sale. This agreement between the claimants and the committee was held to be within the authority of the committee, and was treated as a mortgage upon the bonds by the court, and the claimants allowed to be paid out of the proceeds of the sale, upon the principle that equity will consider that as done which ought to have been done.[2]

After progress in the performance of a reorganization agreement (which provided for a first and second mortgage, the second for the security of bonds with which the trustees were to take up the certificates they had issued for surrendered bonds) had reached the point of the formation of the new company, a majority of the certificate-holders agreed to a modification of the agreement by which they were to receive fifty per cent of their claims in first-mortgage bonds of the new company and the balance in stock. It was held in an action by a non-assenting certificate-holder that the assenting certificate-holders

[1] Davidson *v.* Mexican National R. Co. (1896), 11 App. Div. 28; s. c. 42 N. Y. Supp. 1015.

[2] Central Trust Co. *v.* Carter (1896), 78 Fed. Rep. 225.

It was held in Mowry *v.* Farmers' Loan & Trust Co. (1896), 76 Fed. Rep. 38, that where a committee of bondholders had provided in their plan of reorganization that the holders of the old bonds should surrender them and receive new bonds instead, the surrendered bonds not to be cancelled, but held by the trustee as an additional security, non-assenting bondholders could not be allowed an advantage over assenting bondholders by considering the latter's surrendered bonds extinguished. In the same case there was an agreement that a branch of the road should be sold, and the distribution of the proceeds of the sale left with the committee of bondholders. For the reason that certain bondholders failed to assent, the road was not sold. It was held that by their action the lien of the assenting bondholders was not waived in favor of the non-assenting bondholders.

could not be compelled to receive second-mortgage bonds according to the terms of the first agreement, and that plaintiff could not at this stage compel a specific performance of that agreement as to his bonds; but the court would give him judgment for the value of the bonds he was to receive.[1]

§ 893. **When Right to share in Benefits of Scheme terminates.** — As a general principle it may be said that those who seek to share in the benefits of a reorganization agreement must comply strictly with its provisions as to the time within which they must exercise their option to come into the scheme.[2]

In a decree providing in terms for a purchase by the bondholders it is usual to insert a clause permitting minority bondholders to come in after the purchase within a limited time on equal terms with the purchasing bondholders.[3]

But the court will not revise a decree in which such a clause is not inserted, when there is nothing to show why it was not inserted. Under such circumstances, it will be assumed that there were adequate reasons for the non-insertion.[4]

In an action for damages brought by a stockholder of a defunct railroad company, allegations that the road had been purchased by a committee of bondholders, that upon a question raised by a portion of the stockholders as to the validity of the sale and of the bonds, litigation ensued which was finally compromised, the stockholders agreeing with the committee to withdraw all opposition to the sale, in consideration of being accorded the right to subscribe for stock in a new corporation to be organized upon terms specified in a circular addressed to the stockholders of the original corporation, and that the plaintiff had no notice of the contents of such circular until long after the expiration of the period fixed for the stockholders to come into the scheme, *held* insufficient to support the action, since the agreement was not made by the company or in its behalf. Nor could the plaintiff complain of the terms of the agreement, inasmuch as he was not a party to it, unless he had elected to come in and ratify it in its entirety and not simply the provisions favorable to himself. All the rights of the original stockholders having been destroyed by the foreclosure sale, they had none except those which sprang out of the agreement with the purchasing com-

[1] Dutenhofer *v.* Adirondack Ry. Co. (1891), 14 N. Y. Supp. 558.

[2] The same rule governs where the right of participation depends on a statute. See *post*.

[3] Sahlgaard *v.* Kennedy (1882), 13 Fed. Rep. 242, 250; s. c. on demurrer (1880), 3 Fed. Rep. 302.

[4] Huntington *v.* Little Rock & Fort Smith Ry. Co. (1882), 16 Fed. Rep. 906; s. c. 3 McCrary, 581.

mittee, and if those rights were violated, they should have looked to the parties with whom they contracted. The latter could be held liable for misconduct in the execution of their trust by any stockholder who had adopted the arrangement, but there is no recourse in such a case against the new company itself.[1]

The position of the stockholders in the old company is still weaker, where the agreement between the bondholders not only fixes a time for the payment of assessments on the shares in the new company, but expressly provides that, in case any of those stockholders neglect or refuse to pay the assessments at the time appointed, the privilege of receiving the shares allotted to them shall be ratably distributed among those who have paid their assessments. The residuary benefits thus provided for non-defaulting stockholders become vested rights, as soon as the default occurs, and cannot be thereafter disturbed in favor of a stockholder who has made default.[2]

Similarly a subscriber to a reorganization agreement who agrees to surrender his bonds "when he shall be required to do so," and receive in lieu thereof the new bonds provided for by the plan, cannot claim any benefits under it, or insist on the delivery of the new bonds, if he receives notice to surrender his bonds from the trustee appointed to carry out the agreement, but fails to do so until after the purchase of the road and the formation of the new company.[3]

Where the decree in a railroad foreclosure suit instituted by representative bondholders provides that in case any of the holders of the bonds or coupons become purchasers, they may pay the price in bonds or coupons to a trustee who shall receive a conveyance for them, and such others "as may signify to him their desire to become interested in said purchase, and pay him their due proportion of the sum which may be bidden for the same, and the costs of the suit and other expenses," and it is subsequently agreed at a meeting of the bondholders that the holders of three-fourths in amount of the bonds "shall have power to order a sale by the trustee at such time, place, and manner as they shall think proper," the contingency of a part of the bondholders refusing or neglecting to come in, being thus expressly provided for, the inference is that the parties intend that the right to come into the agreement shall cease as soon as

[1] Thornton v. Wabash Ry. Co. (1880), 81 N. Y. 462.

[2] Dow v. Iowa Central Ry. Co. (1893), 70 Hun, 186.

[3] Carpenter v. Catlin (1865), 44 Barb. 75.

the sale by the trustee is consummated. This inference will prevail even though the conveyance to the vendee is "in trust for all the owners of the bonds," the effect of such a clause being limited by the terms of the decree and the acts of the parties. After the sale is made by the trustee in accordance with the directions of the requisite majority of the bondholders, a non-participating bondholder is relegated to his ordinary right to share in the proceeds of the foreclosure sale, and cannot claim any of the stock of a new company organized by the bondholders under a special statute for the purpose of taking over the road. What each bondholder has throughout the proceedings is not an absolute right of property in the new corporation, irrespective of his own action, but an option to be exercised or not at his own choice, and within such reasonable time as will avoid prejudice to the rights of others. The last moment for the exercise of such option is when the deed is executed, transferring the property to the new corporation.[1]

When a reorganization committee of a railroad, by circular letter, requested the bondholders to deposit their bonds with a certain designated trust company on or before a specified date, a bondholder who neglected so to do, but whose bond was afterwards received by the secretary of the committee for which he gave his individual receipt, was held, nevertheless, entitled to relief as being a valid bondholder, and it was also held that the actual holder, namely, the secretary, in his individual capacity was not under the circumstances a necessary party.[2]

§ 894. **Rights of Parties to Agreement, when complete.** — The acceptance of an original bond by the president and secretary of a permanent committee, appointed by the projectors of a reorganization scheme, and held out to the public as their general agent in the matter of the reorganization, binds the new company, when formed, and gives the person surrendering the bond an irrevocable right to the new one which is to be substituted therefor. If the secretary afterwards hands over the bond so surrendered to the trust company named in the plan as the depositary of the bonds, and receives therefor a certificate in his own name, the bondholder is in no way responsible for his misconduct.[3]

A provision in a reorganization agreement empowering a

[1] Landis *v.* Western Pennsylvania R. Co. (1890), 133 Pa. St. 579; s. c. 19 Atl. Rep. 556.

[2] Hitchcock *v.* Midland Ry. Co. of New Jersey (1880), 33 N. J. Eq. 86.

[3] Midland Railroad Co. of New Jersey *v.* Hitchcock (1884), 37 N. J. Eq. 549; s. c. 14 Am. & Eng. R. R. Cas. 598.

majority in value of the holders of certificates issued in place of the bonds and stock of the mortgagor company to modify the agreement in any manner they may deem best for the interests of all concerned, will not be construed so as to prolong this right of the majority beyond the time when the property passes into the possession of the new company, which is to consummate the scheme by issuing its bonds and stock to the certificate-holders. The rights and obligations of that company become fixed by the conveyance of the property to it, and a subsequent change in the scheme by which it is agreed by a mere majority of the certificate-holders that one set of bonds shall be issued instead of two, as contemplated by the original agreement, is illegal as to a non-assenting participant in the reorganization.[1]

An agreement was entered into by the creditors of a company that they would receive bonds of the new company to be organized to be delivered within "six months" from the "foreclosure sale." At the end of six months the sale had not been confirmed. The court construed that the parties agreeing to deliver the bonds would be entitled to "six months" from the final consummation of the sale before they could be required to deliver them; under the circumstances of the case the court intimated that any other construction of the agreement would be in violation of the principle that a construction that would forfeit a right is not favored in law.[2]

§ 895. **Reorganization: Trustee's Control of Scheme.** — A trust company does not lose control of a scheme to reorganize a railroad company under which it is empowered to ascertain the floating debt and expense of organization, and assess the amount to be paid by stockholders to entitle them to new stock, by the mere fact of an unauthorized and ineffectual attempt of certain of its officers to make an assessment in its name, as where their acts were not ratified by the directors.[3]

§ 896. **Power of Reorganization Committee to fix Date for Maturity of New Issue of Bonds.** — A committee to which is intrusted the regulation of any "matter of detail" which might, in the judgment of all or of a majority of its members, be necessary or expedient for carrying out the plan, acts within the scope of its authority when it causes to be inserted in certain "income

[1] Dutenhofer *v.* Adirondack Ry. Co. (1891), 38 N. Y. St. Rep. 710; s. c. 14 N. Y. Supp. 558.

[2] Houston, E. & W. T. Ry. Co. *v.* Keller (Tex., 1896), 37 S. W. Rep. 1062.

[3] Gernsheim *v.* Central Trust Co. (1892), 40 N. Y. St. Rep. 967; s. c. 16 N. Y. Supp. 127.

bonds," for which the plan provides, a clause giving the company an option to pay the bonds before the date at which they are to mature.[1]

§ 897. **Discretion of Reorganization Trustees as to Issue of Stock in New Company.** — A road was purchased by trustees in behalf of bondholders in pursuance of an agreement, whereby the bondholders were to surrender their bonds, and the road either sold at a given price within a time named, or, in case such sale should not be made, taken over by a new company to be organized by the purchasers from the bondholders. In the latter event it was provided that "the stock of the new company should be issued to and divided among the holders of the receipts for the bonds surrendered to the trustees, in proportion to the number of bonds deposited for which the receipts were issued, upon the surrender to the same trustees of such receipts." The new company was organized, but the trustees did not deliver the whole capital stock to the bondholders. In an action against them by a bondholder for an accounting it was asserted that they failed to perform their duty as trustees. It appeared that the trustees were vested with large discretionary powers in regard to the execution of the reorganization agreement, and that their determination as to the meaning of any provision therein was to be conclusive. It also appeared that the law of the State in which the company was organized limited the issue of capital stock to "the original cost of the construction of the railroad, and the equipment purchased, and such sum as might be necessary to complete the same." Under these circumstances it was held that the trustees could not, in the absence of proof of positive bad faith, be held liable for restricting the amount of paid-up stock to what they deemed the actual value of the road, although it was provided in the articles of incorporation that other stock might be issued by the directors and sold for money or other consideration.[2]

A trust company authorized to determine the amount to be paid by the stockholders of an old company to entitle them to stock in the new, on the reorganization of a railroad, need not notify the stockholders as to when it intends to begin the per-

[1] Lehigh Coal & Navigation Co. *v.* Central R. Co. of New Jersey (1881), 34 N. J. Eq. 88.

[2] White *v.* Wood (1892), 129 N. Y. 527; s. c. 29 N. E. Rep. 835; 51 Am. & Eng. R. R. Cas. 73.

A scheme of reduction under which a portion of the capital of a company was to be returned to the shareholders was confirmed by the court upon the statutory requirements being observed, although it was to be immediately borrowed on debentures. *In re* Nixons Navigation Co. (1897), 1 Ch. 872.

formance of its task. But the stockholders may demand a hearing.[1]

§ 898. **Discharge of Liens of Creditors participating in Scheme, when inferred.** — When a reorganization scheme to which both the bondholders and certain judgment creditors are parties plainly shows an intention that the new securities to be issued on a like basis to them shall extinguish their debts, the consummation of the scheme operates as payment of the claims thus provided for, and neither the bondholders nor the judgment creditors have any claim upon the proceeds of the foreclosure sale. That the purchasing committee are given by the plan the most ample powers in regard to the bonds deposited with them, does not, after the plan is carried out, in any sense imply that the bonds are to be considered as unpaid. Nor has a provision in such plan, authorizing the committee to receive the proceeds of the sale, any application to the condition of affairs arising when the committee becomes itself the purchaser of the whole road.[2]

§ 899. **Bondholders accepting Preferred Stock in New Corporation give up their Rights as Creditors.** — Bondholders who surrender their bonds in pursuance of a scheme of reorganization and receive in lieu thereof preferred stock in the new company under an agreement entitling them to dividends "out of the net earnings of the road (if earned in the current year, but not otherwise) not to exceed seven per cent, in any one year payable semi-annually, after payment of mortgage interest and delayed coupons in full," are to be considered as having abandoned their position as creditors for that of stockholders, entitled to claim only dividends declared out of the net earnings of any particular year. Moreover, in the computation of those net earnings all the operations and business of the company must be viewed as a unit, the main line and auxiliaries to be considered with reference to their interdependent necessities and with regard for the benefit of all interested in the property. Rents, under leases taken after the issue of the preferred stock and interest on a loan of money, also borrowed after "such issue to equip the road," are, therefore, properly paid before such dividends.[3]

Preferred stock issued to bondholders in a reorganization scheme, entitling them to "non-cumulative dividends, at the rate of six per cent per annum in preference to the common stock,

[1] Gernsheim *v.* The Central Trust Co. (1891), 40 N. Y. State Rep. 967.

[2] Central Trust Co. *v.* Cincinnati, J. & M. Ry. Co. (1892), 58 Fed. Rep. 500.

[3] St. John *v.* Erie Ry. Co. (1875), 22 Wall, 136; affirming s. c. 10 Blatch. 271 (1872).

but dependent on the profits of each particular year, as declared by the Board of Directors," does not operate to deprive the directors of the discretion with which managing agents of corporations are usually invested, when distributing the earnings of property committed to their hands. The words "as declared by the Board of Directors" in this provision refer to "dividends," not to "profits," and the directors therefore have the power to devote the profits of any given year to improvements of the property to the exclusion of any dividend to the preferred stockholders.[1]

If income bonds are issued under a reorganization plan, instead of preferred stock, the interest thereon is regarded as dividends, in so far that it cannot be paid before the floating debt incurred in each interest period.[2]

Preferred stockholders in a reorganized company cannot claim a priority of payment for their dividends, unless a specific lien is shown beyond all doubt to exist in their favor, and whether or not such a lien exists, must depend upon what actually occurred, and upon the stipulations affecting the property which were entered into by parties who had the right to encumber it, and not upon what might have been in the minds of the stockholders at the time these various transactions took place.[3]

§ 900. **Restoration of Bondholder to his Rights as Creditor, when properly refused.** — When the question is merely as to the proper distribution of the proceeds of a foreclosure sale under a mortgage designed to secure new bonds issued in exchange for old ones of several classes, and not the settlement of general rights and equities between the parties, the court will not entertain a petition by a bondholder to be allowed to share in such proceeds when his right to do so is placed upon the existence of a special equity in his favor, the fund being insufficient to satisfy the bonds of a class

[1] New York, L. E. & W. R. Co. *v.* Nickals (1886), 119 U. S. 296; s. c. 7 Sup. Ct. Rep. 209, referring to St. John *v.* Erie R. Co., *supra*, and Warren *v.* King (1883), 108 U. S. 389, and overruling the decision of the lower court in Nickals *v.* N. Y., L. E. & W. R. Co. (1883), 15 Fed. Rep. 575; s. c. 13 Am. & Eng. R. R. Cas. 139.

[2] Lehigh Coal & Navigation Co. *v.* Central R. Co. of New Jersey, 34 N. J. Eq. 88.

[3] King *v.* Ohio & Mississippi R. Co. (1880), 2 Fed. Rep. 36. In this case the certificates provided that the preferred stock was to be a first claim on the property of the corporation after its indebtedness, and that the holder was to receive a certain rate of interest from the net earnings, before any payment of dividends on the common stock.

It was held that the effect of the agreement was to provide a mode by which a preference should be given to a particular class of stockholders, and that the parties did not contemplate that the "indebtedness" referred to was only that indebtedness which existed against the company, when the agreement was made.

which, by the terms of the arrangement leading to the execution of the new mortgage, were to take precedence of the new ones received by the petitioner.[1]

§ 901. **Who estopped to object to Reorganization Scheme.**[2] — Exceptions to a sale in foreclosure will not be entertained in favor of a bondholder who has been made a party to a reorganization scheme, and has surrendered his bonds in exchange for the stock and bonds of the new company, for by so doing he elects to abide by the action of the trustees.[3]

So, also, a bondholder who receives the bonds of the new company allotted to him, and attempts to buy more, and brings suit for some he claims to be his, and acts in every way as if he acquiesced in the proceedings of the purchasing committee, is estopped to object to the validity of the reorganization scheme on the ground that his representative on the committee exceeded his powers.[4]

The consent of bondholders required by statute in Wisconsin to a sale made in pursuance of a reorganization scheme may properly be inferred from the silence during the whole of a protracted litigation, carried on with prior incumbrances by a corporation formed to take the title to the property for the benefit of such bondholders.[5]

§ 902. **Plans held equitable, or the contrary.** — The court will strive to give effect to a fair arrangement, passing over mere technical defects.[6]

[1] *Ex parte* White, *In re* Jesup, Wilmington & Manchester R. Co. (1871), 2 S. C. 469.

There the petitioner alleged, as a ground for receiving the relief asked for, that he had exchanged his old bonds for new ones on the understanding that if all the bondholders did not come into the arrangement, the original securities were to be returned to him. His demand, therefore, was that, so far as he was concerned, the fund should be distributed on equitable principles. The court said that if he had a right to disturb the arrangement, he had an appropriate remedy, but that, as his only claim then recognizable was to participate in the distribution of the assets, it was a sufficient answer to his petition, that the question of his right in respect to the assets did not depend on the issue of fact raised by his allegations.

[2] An outside purchaser cannot be heard to object to the terms of a decree of sale, much less a company formed by arrangement between the parties controlling the sale. Compton *v.* Jesup (1897), 167 U. S. 1.

[3] Crawshay *v.* Soutter (1867), 6 Wall. 739.

[4] Matthews *v.* Murchison (1882), 15 Fed. Rep. 691; s. c. 9 Am. & Eng. R. R. Cas. 693.

[5] Barnes *v.* Chicago, M. & St. Paul Ry. Co. (1886), 122 U. S. 1; s. c. 7 Sup. Ct. Rep. 1043.

[6] *In re* Dynevor, etc. Collieries Co. (1879), 11 Ch. D. 605.

In England a scheme conferring power upon a statutory majority to make binding any compromise or arrangement which the court might sanction requires the sanction of the court. *Re* Land Mortgage Bank of Florida (1896), 3 Manson, 164.

Pending an injunction and receiver, a

Where it is to the interest of a railway company that the rights of all bondholders of several series of mortgage bonds should be cut off to enable the company to reorganize, a decree foreclosing all the mortgages, entered by consent of the creditors, will not be set aside at the suit of a stockholder on the ground that the principal of some of the mortgages is not yet due.[1]

Unsecured creditors may have a plan of reorganization set aside which makes no provision for the payment of their debts, and contemplates not only a complete absorption by the purchasing committee, or its successors, of the entire property of the company, free from all liability for its debts, but also a distribution of a large sum of money among the stockholders, who, under the doctrine that the corporate assets are a trust fund for the benefit of the creditors, hold their interest subject to the debts of the company.[2]

It is an act of fraud for a bondholder to employ the mortgage security as an instrument whereby he may obtain for himself the mortgaged property at the lowest price, leaving his associate bondholders unpaid. "Community of interest involves mutual obligation." Nor are the managers and officers of a company, who are trustees as well for stockholders as creditors, any less culpable if they seek their own profit at the expense of its stockholders, or even its bondholders. It is their duty in case of a sale of the corporate property to secure the highest possible price obtainable.[3]

The court will scrutinize the resolutions of creditors, although recognizing them as the better judges of what is to their commercial advantage.[4]

Where it appears that amongst the majority were voters who were not acting in good faith, the court will not sanction a reconstruction.[5]

corporation may take steps towards a reorganization, employing agents and otherwise incurring liability. Linn *v.* Joseph Dixon Crucible Co. (1896), 35 Atlantic Rep. 2.

A petition for confirmation of a scheme between a railway company and debenture-holders, which included the purchase of the petitioning company's undertaking under legislative authority was denied, in the interests of general creditors, until a bill before Parliament was actually passed. *In re* Eastern and Midland Ry. Co. (1892), 67 L. T. 711.

[1] Carey *v.* Houston, etc. Ry. Co. (1891), 45 Fed. Rep. 438.

[2] Railroad Company *v.* Howard (1868), 7 Wall. 392.

[3] Jackson *v.* Ludeling (1864), 21 Wall. 616.

[4] *In re* English, Scottish, & Australian Chartered Bank (1893), 3 Ch. D. 385, 409.

[5] *In re* Wedgwood Coal & Iron Co. (1877), 6 Ch. D. 627; *In re* Empire Mining Co. (1890), 44 Ch. D. 403.

But where the affairs of a company could not be restored to their original position, a winding-up scheme was sanctioned which shut out from participation in the distribution of the assets the ordinary shareholders, notwithstanding that the day before their meeting a letter was written to

And any arrangement between the secured creditors and the debtor company, as, for example, an agreement between them to avoid a sale and lease the property for their own benefit, but to the detriment of unsecured creditors, will be annulled at the instance of the latter.[1]

On the other hand the unsecured creditors cannot object to a scheme which gives them, in lieu of their evidences of debt against the old company, second preferred income bonds, equal to the amount of the floating debt and interest thereon. Such an arrangement places them in at least as advantageous a position with regard to the new as they held towards the old company.[2]

§ 903. **Rights of Stockholders after Reorganization.** — (a) *Right to take Part in the Management of the Property.* — The stockholders of the old company who accept a reorganization scheme which provides that they shall be entitled to become the legal owners of the stock issued by the new company after the bondholders have received three annual instalments of the interest on their bonds, and that in the mean time the business of the corporation is to be controlled by the bondholders, have no standing in court to object to a lease of the road which is satisfactory to the bondholders, when it appears that the liabilities of the corporation are so great, as compared with its assets, that there is an extremely remote prospect that their legal rights as shareholders will ever attach.[3]

A reorganization agreement which provides for separating the right to vote from the holder of the stock, and confers that right upon a trustee representing the bondholders, to be exercised until certain mortgage debentures issued in lieu of the original evidences of debt held by the railroad company are paid, is not void *per se*, as against public policy. Especially is such an agreement unobjectionable when the charter of the company expressly provides that the votes of the stockholders "may be given in person or by proxy."[4]

(b) *Right to enjoin Diversion of Earnings.* — Where the reorganization scheme provides that certificates shall be issued to

induce a ratification, by a large holder of debentures and preference shares. Buenos Ayres Water Supply Co., *In re*, 66 L. T. 408.

[1] Farmers' Loan & Trust Co. *v.* Missouri, I. & N. Ry. Co. (1886), 21 Fed. Rep. 264, 267.

[2] Hancock *v.* Toledo, Peoria, & Wabash R. Co. (1882), 9 Fed. Rep. 738.

[3] McHenry *v.* New York, P. & O. R. Co. (1884), 22 Fed. Rep. 130; s. c. 22 Am. & Eng. R. R. Cas. 50.

[4] Mobile & Ohio R. Co. *v.* Nicholas (1893), 98 Ala. 92; s. c. 12 St. Rep. 723; 57 Am. & Eng. R. R. Cas. 100.

As to the right to vote by proxy, and as to how far agreements conferring that right are affected by considerations of public policy or otherwise, see Mobile & Ohio R. Co. *v.* Nicholas (1893), 98 Ala. 92.

the stockholders of the old company, which they shall have the right to exchange for common stock in the new if the earnings of the road prove sufficient to defray the cost of necessary repairs and improvements, and pay five consecutive annual dividends of seven per cent to the preferred stockholders, the holders of the certificates are entitled to prevent by injunction any plain diversion of the earnings to their prejudice. But in the absence of any showing that such a diversion is imminent, no injunction will be issued until the account of the income and its application has been satisfactorily adjusted.[1]

§ 904. **Effect of Reorganization upon Liabilities of Old Company.** — Where the bondholders of a second mortgage reorganize after foreclosure, as between the company thus formed and creditors of the old company who had been secured by the first mortgage, no privity exists to render the new company liable upon the certificates of indebtedness. The liability "did not run with the property into the hands of those who acquired it by foreclosure."[2]

§ 905. **Costs in England on Reconstruction.** — Costs were refused to certain claimants in proceedings to reconstruct, for the reason that their appearance was unnecessary, as the liquidator could take care of their interests.[3]

Costs were denied to dissentient debenture-holders on the ground of unreasonable opposition to a scheme of reconstruction.[4]

§ 906. **In Conclusion.** — The last chapter of this work deals to some extent with the same subjects as those embraced in the earliest chapters. The process of reorganization results in new issues of securities, and the questions surrounding the creation of the corporation and its original securities again arise. The litigations which have been passed in review constitute the legal history of American railway bonds and mortgages. The evolution of the law on these subjects has been largely accomplished. The next ten years ought not to result in the same amount of railway litigation irrespective of the question of commercial prosperity, and its effect upon the business environment of railway companies.

[1] Mackintosh *v.* Flint & Pere Marquette R. Co. (1888), 32 Fed. Rep. 350.

[2] Sullivan *v.* Portland, etc. R. Co. (1876), 94 U. S. 810.

In England the court will preserve all rights against shareholders by requiring a provision continuing their liability as shareholders in the old company while their shares are not fully paid up. *In re* London Chartered Bank of Australia (1893), 3 R. 696.

[3] *Re* Albert L. A. Co. (1871), 6 Ch. App. 387.

[4] *In re* Tunis Ry. Co. (1874), W. N. 121.

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